REGULATING MONEY LAUNDERING IN DEVELOPING COUNTRIES
A CRITICAL ANALYSIS OF SOUTH AFRICA'S INCORPORATION AND IMPLEMENTATION OF THE GLOBAL FATF STANDARDS

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Declaration

I declare that "*Regulating money laundering in developing countries: a critical analysis of South Africa's incorporation and implementation of the global FATF standards*" is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references

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Signature

January 2013

To my late brothers and sister Sbongiseni, Cebolenkosi and Mancane

The late Gogo MaDidi and Johannes Madlala

My grandfathers, the late Khulumani Hlophe and Simphiwe Mahlaba

My father, the late Gabangaye Hlophe

And to my mother, Thembani Mahlaba.

Lists of Key Abbreviations

AAM	Anti-Apartheid Movement
ABSA	Amalgamated Banks of South Africa
ABSIP	Association of Black Securities and Investment Professionals
AFU	Assets Forfeiture Unit
AML	Anti-Money Laundering (also used to collectively refer to AML/CTF)
AML/CTF	Anti-Money Laundering and Counter Terrorism/Terrorist Financing
AMLAC	Anti-Money Laundering Advisory Council
AMLCRs	Anti-Money Laundering Control Regulations of 2002
AMLRO	Anti-Money Laundering Reporting Officer
ANC	African National Congress
APG	Asia Pacific Group on Money Laundering
ARA	Asset Recovery Agency, UK
ATM	Automatic Teller Machine
Banking Council	Banking Council of South Africa or BASA
BASA	Banking Association of South Africa (Banking Council of South Africa)
BCBS	Basle/Basel Committee on Banking Supervision
BCSA	Banking Council of South Africa or BASA
BFA	Bankable Frontier Association
BIS	Bank for International Settlements
BRICS	Brazil, India, China and South Africa group of countries.
BSA	*Bank Secrecy Act*, *1970*- US
BSD	Banking Supervision Division of the South African Reserve Bank
CDD	Customer Due Diligence
CDD/KYC	Customer Due Diligence/Know Your Customer
CenSEC	Centre for the Study of Economic Crime
CFATF	Caribbean Financial Action Task Force
CFT/CTF	Counter Financing of Terrorism/Counter Terrorist Financing
CGAP	Consultative Group to Assist the Poor
CHAPS	Clearing House Automated Payment System
CIA	Central Intelligence Agency

COSATU	Congress of South African Trade Unions
CPSS	Committee on Payments and Settlements Systems
CRAs	Credit Rating Agencies
CRB	Community Reinvestment Bill
CTF/CFT	Counter Terrorist Financing
CTRs	Cash Threshold/Transaction Reports
DPCI	Directorate of Priority Crime Investigations (Hawks)
DPP	Director of Public Prosecutions
Drugs Act	*Drugs and Drug trafficking Act of 1992*
DSO	Directorate of Special Operations/ see Scorpions
EAG	Eurasian Group
ESAAMLG	Eastern and Southern African Anti-Money Laundering Group
EU	European Union
ExCON	Exchange Control Division of the South African Reserve Bank
FATF	Financial Action Task Force
FICA	*Financial Intelligence Centre Act, 2001*
FinCEN	Financial Crimes Enforcement Network
FIU(s)	Financial Intelligence Unit(s)
FNB	First National Bank
FSA	Financial Services Authority
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board- G20
FSB	Financial Services Board- South Africa
FSC	Financial Sector Charter
FSCF	Financial Sector Campaign Forum /Coalition
FSRB	FATF-Style Regional Body
FSSA	Financial System Stability Assessment
FSSC	Financial Services Sector Coalition
FTRs	Financial Transaction Reports
G 20	Group of 20 (most richest countries)
G 7	Group of 7 (most richest countries)
G 8 (+5)	Group of 8 (most richest countries (including Russia) and 5 most influential developing countries)

G:enesis	G:enesis Analytics (Pty) Ltd
GAFISUD	Financial Action Task Force on Money Laundering in South America
GAO	Government Accountability Office, GAO
GDDS	General Data Dissemination System
GIABA	Intergovernmental Action Group against Money laundering in Africa
Hawks	Directorate of Priority Crimes Investigations- South Africa
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IFA	International Federation of Accountants
IFIs	International Financial Institutions (IFIs) (IMF and World Bank)
IMF	International Monetary Fund
IRS	Inland Revenue Service, US
IOSCO	International Organisation of Securities Commission
KYC	Know Your Customer
KYC/CDD	Know Your Customer/Customer Due Diligence
LEAs	Law Enforcement Agencies
LOA	Life Offices' Association (a trade association of long time insurance service providers in South Africa)
LSM	Living Standards Measures
LSSA	Law Society of South Africa
MENEFATF	Middle East and North Africa Financial Action Task Force
MLTFC Regulations	Money Laundering and Terrorist Financing Control Regulations
MONEYVAL	Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures
Mzansi	Mzansi Bank Account Initiative
NA	National Assembly (one of the two houses of parliament in South Africa)
NCCT	Non-Cooperating Countries and Territories
NCOP	National Council of Provinces (one of the two houses of parliament in South Africa)
NDPP	National Directorate of Public Prosecutions
Nedlac	National Economic Development and Labour Council
NEPAD	New Partnership for Africa's Development
NIA	National Intelligence Agency

NPA	National Prosecuting Authority
NPAA	*National Prosecuting Authority Act, 1998*
NPS	National Prosecution Services
OCCA	*Organised Crime Control Act*, *1970*- US
OECD	Organisation for Economic Cooperation and Development
PCA	*Proceeds of Crime Act, 1996*- South Africa
PEP	Politically Exposed Persons
POCA	*Prevention of Organised Crime Act*, *1998*- South Africa
POCDATARA	*Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004*- South Africa
ROSC	Reports on Observance of Standards and Codes
s.	Section
SABRIC	South African Banking Risk Information Centre
SACP	South African Communist Party
SAICA	South African Institute of Chartered Accountants
SALC	South African Law Commission /SALRC
SALRC	South African Law Reform Commission /SALC
SAPO	South African Post Office
SAPS	South African Police Services
SARB	South African Reserve Bank
SARS	South African Receiver of Revenue
SARS	South African Receiver of Revenue
SARs	Suspicious Activity Reports
SASS	South African Secret Service
SBG	Standard Bank Group
SBP	Small Businesses Project
SCCU	Specialised Commercial Crimes Unit (of NPA)
Scorpions	Directorate of Special Operations- see DSO
SDDS	Special Data Dissemination Standard
SMS	Suspicious Matters Reports
SOCA	Serious Organised Crime Agency, UK
STR(s)	Suspicious Transaction Reports
UK	United Kingdom

UKFIU	United Kingdom Financial Intelligence Unit
UNDOC	United Nations Office on Drugs and Crime
US	United States
UTRs	Unusual Transaction Reports
Vienna Convention	*UN Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988*
ZACC/CC	Constitutional Court, South Africa
ZAR	South African Rand
ZASCA/SCA	Supreme Court of Appeal, South Africa

Regulating money laundering in developing countries: a critical analysis of South Africa's incorporation and implementation of the global FATF standards

Abstract

This work uses the competing theories of regulation and 'policy transfer' analysis to examine why and how the global Financial Action Task Force (FATF) regime against money laundering emerged and was introduced in developing countries, particularly South Africa. It also examines the regime's implementation efforts within South Africa's banking sector. The popular explanation from the FATF is that this regime was introduced to help in dealing with issues of crime and protecting the financial system against abuse by criminals. The inquiry unfolds in the context of South Africa's dual socio-economic conditions that straddle the developed-developing country divide. Findings of this study are that the global FATF regime did not primarily emerge for the proclaimed purposes of detecting or combating crime or to protect the global financial system from abuse by criminals. It may have instead emerged to deal with issues of competition, particularly regulatory and tax arbitrage. Evidence also clearly shows that the regime was imposed on many developing and small countries through the FATF's strategies of naming, shaming and blacklisting those it labelled as Non-Cooperating Countries and Territories at the turn of the 21st century. The spread of the regime throughout the world at all costs appears to point towards a concerted drive to use or manipulate public sentiment about crime and to stigmatise mainly small and developing countries to the benefit of the narrow political and economic interests of some Western countries. Regarding the introduction of the FATF standards into South Africa, evidence shows that although the country was not blacklisted and was eventually made a full member of the FATF, the regime was, nevertheless imposed. In examining the imposition of these standards in South Africa, we found some of their crucial aspects were not designed for implementation under the socio-economic conditions of underdevelopment. Evidence also shows that they are not effective in detecting and combating crime despite the great, yet uncalculated, cost of compliance that they impose on society.

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Introduction

This thesis examines the emergence and adoption of the global Financial Action Task Force (FATF) standards against money laundering and their implementation in developing countries and, in particular, South Africa. It identifies and examines the principal objectives and purposes of particularly the financial regulatory aspects of the FATF standards, questioning their design and aggressive implementation, high costs, especially the Know Your Customer/Customer Due Diligence (KYC/CDD) measures, when implemented under developing country socio-economic conditions. It also examines the impact and effect of reporting financial transactions of customers to the so-called financial intelligence units (FIUs) in trying to detect or combat money laundering and related crimes. Lastly, it examines the legitimacy of these standards, seeking to explain why developing countries continue to implement them despite their high costs and evidence that points to their failure to achieve their principal objectives and purposes.

The FATF standards against money laundering were introduced after the formation of the FATF in 1989. At that time, they were called the 40 Recommendations against money laundering[1]. After what has become known as the 9/11 terrorist attacks in the US in 2001, nine special recommendations were added to the FATF standards, which led to them being called the 40+9 Recommendations against money laundering (AML) and counter-terrorism financing (CTF)[2]. We refer to these Recommendations in this thesis as the FATF standards. They are very broad and include recommendations aimed at detecting and combating money laundering by criminalizing it[3], seizing and confiscating proceeds of crime[4], fostering cooperation between countries[5], and requiring financial and non-financial institutions and professionals to report 'suspicious' and 'unusual' transactions and transactions above certain thresholds to the newly established FIUs[6].

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[1] See FATF. 1990. *Financial Action Task Force on Money Laundering: Report 1990*. Paris: FATF Secretariat

[2] See FATF. 2003. *The Forty Recommendations: incorporating the amendments of 24 October 2004*. FATF Recommendations, Paris: FATF Secretariat.

[3] *Ibid.* Recommendation 1 to 2

[4] *Ibid*. Recommendation 3

[5] *Ibid.* Recommendation 35 to 40

[6] *Ibid.* Recommendation 4 to 34

Many scholars have written on the topic of money laundering[7], some focusing on the phenomena itself, its impact, extent and quantification, some on the laws and regulations that were introduced to try and curb it. Due to its multidisciplinary nature, it has attracted input from diverse scholarly disciplines such as legal scholars, criminologists, economists, global governance and international relations, among others. It also easily lends itself to multidisciplinary research and interpenetration of various fields of law. This study focuses on the financial or business regulatory aspects of the FATF standards. These standards seek to regulate financial and non-financial businesses and require professionals to identify and verify residential addresses of their customers with a view of profiling them and reporting any of their transactions which may potentially be linked to criminal activities. This is done with a view to enlisting their assistance in uncovering and combating crime and of preventing them from being misused to facilitate crime, particularly serious revenue-generating crime and the financing of global terrorism activities[8].

This is therefore a study of 'regulation' at different levels, both global and national. At a global level, we examine the emergence of the money-laundering regulatory measures and their

[7] Alldridge, P. (2003). *Money laundering law: forfeiture, confiscation, civil recovery, criminal laundering and taxation of the proceeds of crime*. Oxford, UK: Hart Publishing. Ashe, T.M. & Reid, P.L.L.M. (2000). *Money laundering: risks and liabilities*. Dublin, IR: Round Hall Sweet & Maxwell. De Koker, L. (2002). *Money laundering in South Africa*. Centre for the Study of Economic Crime, Johannesburg, ZA: Rand Afrikaans University. De Koker, L. (2006). Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime*, Vol. 13(1): 26-50. De Koker, L. (2008). *Money laundering and terror financing risk management of low risk financial products and services in South Africa: a report prepared for FinMark Trust*. The Centre for Financial Regulation and Inclusion (CENFRI), May 2008. Hinterseer, K. (2002). *Criminal finance: the political economy of money laundering in a comparative legal context*. The Hague, HOL.: Kluwer Law International; Levi, M. 1991. Regulating money laundering: the death of bank secrecy in the UK. *British Journal of Criminology.* Vol. 31(2), pp. 109-12. Bosworth-Davies, R. (2007). Money laundering: the implications of the global money laundering laws-chapter five. *Journal of Money Laundering Control.* Vol. 10 (2), pp. 189-208. Bosworth-Davies, R. (2006). Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control.* Vol. 9 (4), pp. 346-364. Gold, M, & Levi, M. (1994). *Money laundering in the UK: an appraisal of suspicious-based reporting*. London, UK: The Police Foundation. Goredema, C. (2005). Measuring money laundering in Southern Africa. *African Security Review*, Vol. 14(4). Hülsse, R. (2007). Creating demand for global governance: the making of a global money laundering problem. *Global Society.* Vol., 21(2), pp. 155-178. Hülsse, R. (2009). Even clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended. *Regulation and Governance*, Vol. 2, 459-479. Mitsilegas, V. (2003). Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance, in *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. London, UK: Routledge. pp. 195-209. Schudelaro, A. A. P. (2003). *Electronic payment systems and money laundering: risks and countermeasures in the post-internet hype era*. Nijmegen, NED: Wolf Legal Publications.

[8] FATF. 2003. *The Forty Recommendations: incorporating the amendments of 24 October 2004*. FATF Recommendations, Paris: FATF Secretariat.

spread to developing countries. At a national level, we focus on the adoption and implementation of these standards in developing countries with a particular focus on South Africa. With regards to their adoption we focus on whether this process was as a result of rational policy learning or through imposition, analysing the role played by various players and their interests. In other words, we adopt a 'policy transfer' analysis. At a national level, the regulation of private businesses to assist in the detection and combating of crime requires them to perform quasi-law enforcement functions which are not their primary business[9].

Since this is a study of regulation, we have developed a theoretical framework that is anchored in the theories of regulation, particularly the 'public interest' and 'private interest' theories of regulation. Regulation theories seek to explain why and how regulation emerges. Using this framework, we developed competing hypotheses concerning the emergence of the FATF regulatory regime. Based on the public interest theories of regulation, this study examines the hypothesis that the recommendations of the FATF that governments, throughout the world, should regulate their banks and other financial institutions, were primarily directed at detecting and combating money laundering and protecting the global financial system from abuse by criminals. It pits this against a competing hypothesis, anchored in the 'private interest' theories of regulation, which contends that these business regulations emerged primarily to prevent competition and regulatory arbitrage for US's financial institutions.

This thesis is made up of this introduction and a conclusion at the end, which contains some key recommendations. In-between these, there are 8 chapters. The last 4 (chapters 5, 6, 7, and 8) are directed at testing opposing hypotheses. This work is structured as follows. Chapter 1 introduces our topic in more depth, particularly and broadly-- the global regime against money laundering. It ends by discussing the purposes and delimitations of the study. Chapter 2 looks at how we may think of the FATF standards of business regulation- which now form a central strategy of detecting and combating money laundering and its predicate offences in many countries. We argue that these regulatory strategies espouse the 'situational crime prevention' and the 'risk

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[9] Levi, M. 1991. Regulating money laundering: the death of bank secrecy in the UK. *British Journal of Criminology*. Vol. 31(2), pp. 109-125.

regulation' strategies to detect and to combat crime. In regulating private businesses, these approaches do not focus on the offender directly, but indirectly-- by seeking to manipulate the situational settings which make it possible for crime to occur. We argue that these regulatory strategies have been widely used in dealing with crime in general and have their own weaknesses which may beset the achievement of the alleged public interest goals of detecting and combating crime.

Chapter 3 discusses the regulation theories which were used in developing our competing hypotheses of public and private interest. We tie these with our empirical research methods, which involved archival research and fieldwork interviews with compliance officers, law enforcement officials, anti-money laundering regulatory supervisors and other private organisations and individuals. Chapter 4 discusses South Africa's legislative, regulatory and institutional framework against money laundering and terrorist financing. These measures are still new in South Africa, having been implemented in just over a decade. In this part we discuss the provisions of the 3 main pieces of legislation enacted to deal with organised crime, money laundering and terrorist financing; the Prevention of Organised Crime Act (POCA) of 1998, the Financial Intelligence Centre Act (FICA) of 2001, and the Protection of Constitutional Democracy against Terrorist and Related Activities (POCDATARA) of 2004. Our main focus is on POCA and FICA. POCA criminalises money laundering and provides for asset confiscation and forfeiture measures, which appear to have been pursued aggressively by South Africa's Asset Forfeiture Unit, as attested to by case law (which we also discuss). FICA established South Africa's Financial Intelligence Unit, the Financial Intelligence Centre, and provides for the business regulatory measures for combating money laundering and terrorist financing.

In Chapter 5 we offer some critical analysis and explanations of the FATF regime's emergence. Using our competing hypotheses of public and private interest we begin to examine how and why the global FATF regime emerged and why and how it was introduced into South Africa. We ask if this introduction was as a result of voluntary 'policy learning' by South African authorities or was it a result of 'coercive policy transfer'. This chapter provides some firm evidence which points towards the latter. We argue that this brings into question the primary objectives and purposes of introducing the regime. Chapter 6 examines the implementation of the FATF business regulations within the financial banking sector in South Africa. We find that from the early years of implementation there were serious challenges with the KCY/CDD component of the regulations. These logistical and structural challenges in implementing KYC/CDD stemmed from the tensions between the country's socio-economic conditions and historical spatial distortions in which a large section of the population would potentially be excluded from accessing basic financial services as they were unable to meet the documentary requirements for KYC/CDD. Examining this issue of socio-economic exclusion, we argue that implementing KYC/CDD could frustrate social cohesions as some sectors of the population, especially those that were excluded by apartheid would again be excluded in the name of adhering to 'international best practice standards' of the FATF.

In Chapter 7 we ask whether implementing the FATF's business regulations has helped in any way to detect and prosecute money laundering and terrorist-financing activities in South Africa. Here we analyse, among others, statistics emanating from the FATF's mutual evaluation reports of South Africa between 2003 and 2008. We conclude that in South Africa, the reporting of suspicious customer transactions by regulated businesses to the FIC has so far not registered the attainment of the global regime's goals of detecting and combating crime. This chapter also shows that the ineffectiveness of reporting customer transactions is not a unique phenomenon to South Africa, but it also occurs in the UK and the US. This chapter provides recommendations for South Africa to review its reporting regime in a bid to try and improve its effectiveness in detecting crime and to relook at the role of South Africa's FIU, the Financial Intelligence Centre.

In our final chapter, we step back to explain why South Africa, and other developing countries, continue to implement a regime that does not yet assist them to detect and combat crime, (as found in Chapter 7), and may further lead to socio-economic exclusion, (as found in Chapter 6) thus detrimentally affecting the country's socio-economic development. We question the legitimacy of the global FATF regime from its inception to its lack of the anticipated outcomes that it claimed, still arguing that it emerged to further narrow interests. We conclude by summarising our key findings and by proposing some key recommendations.

Chapter 1

Regulating money laundering in developing countries

Introduction and overview

In 2001, South Africa passed the Financial Intelligence Centre Act of 2001 (FICA) in what seemed to be the country's resolve to cement its legislative and regulatory architecture for tackling serious and organized profit-driven crimes. This was seven years into the country's transition from apartheid to democracy. The general explanation for the purposes of this transformative piece of legislation was that it was meant to establish South Africa's Financial Intelligence Unit, the Financial Intelligence Centre, and to regulate private businesses to detect and combat the laundering of proceeds of crime. FICA was later amended to accommodate measures to counter terrorism, following the passing of the Protection of Constitutional Democracy against Terrorist and Related Activities Act, Act 33 of 2004 (or POCDATARA).

The latter was enacted following the 9/11 bombings of the World Trade Centre in the US and international pressure that was put on all countries to fight so-called 'global terrorism'. The popular and well-articulated accounts by some academics and governments alike for the rationale behind the enactment of the FICA regulatory regime are two-fold-- combating crime and protecting regulated businesses from being misused by criminals for illegal purposes[10]. It was said that FICA was enacted to arm South Africa with the necessary legal, regulatory and institutional instruments to tackle organized crime and its underlying motives[11]-- the income and profits it generates for the successful 'crimepreneurs'.

[10] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. Retrieved from: http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf
[11] *Ibid.*

To further justify the regulatory regime, it was argued that South Africa's organized crime had intensified following the country's political transition from apartheid to democracy, the subsequent opening up of borders and economic liberalisation[12]. Under apartheid, Mark Shaw and Peter Gastrow, particularly, argued, South Africa was isolated from the rest of the world due to the UN-imposed political and economic sanctions[13]. When South Africa opened up socially, culturally and economically, local and international organised crime groups saw an opportunity for the establishment of a 'new' market and entered to take advantage of it[14]. It was further claimed that these criminals benefited from, among other things, weaker law-enforcement institutions and inadequate laws as institutions were undergoing an inevitable political transition pursuant on the new democratic constitutional dispensation[15]. The country's transformation of the state apparatus had led to high employee turnover which, accompanied by weaker or outdated laws, created a fertile ground for sophisticated and organised crime groups[16]. These weaknesses, we are told, coupled by the country's acclaimed and sophisticated banking and transportation networks, combined to create a thriving environment for organized crime in a globalised world[17]. Given all these factors, the FICA regime would seem to have been a welcome and necessary effort for South Africa's fight against organised crime.

The central strategy for dealing with organised crime in South Africa has generally followed international trends of criminalizing and targeting the 'proceeds' and 'instrumentalities' of crime. To effectively deal with organized crime, it has become common to regulate private businesses and professionals, both financial and non-financial, such as banks, insurance brokers, accountants and auditors, casinos, lawyers, estate agents and dealers in high value goods- such as

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[12] See Shaw, M. 1998. *Organised crime in post-apartheid South Africa*. Occasional Paper, Safety and Governance Programme: Institute of Security Studies, Pretoria. Gastrow, P. 1999. Main trends in the development of South Africa's organised crime. *African Security Review*, Vol. 8(5). Irish, J. & Qhobosheane, K. 2005. South Africa. in *Penetrating state and business: organised crime in Southern Africa*. P. Gastrow (ed.)
Pretoria: Institute of Security Studies.
[13] *Ibid.*
[14] *Ibid.*
[15] *Ibid*
[16] *Ibid.*
[17] *Ibid.*

automobile/motor dealers, dealers in precious stones and metals and foreign exchange bureaus. It is generally argued that all these businesses and professionals are vulnerable to misuse by criminals to facilitate crime by laundering proceeds from their illegal activities. They should therefore be regulated to monitor such laundering activities and to report these to the newly established Financial Intelligence Units.

Money laundering was made an offence in South Africa when the Drugs and Drug Trafficking Act (or Drugs Act) was passed in 1992. The Drugs Act criminalised the laundering of proceeds of sales of illicit drugs and other drug-related offences. This was, however, not enough since criminals laundered proceeds of all sorts of crime[18]. In 1996, all proceeds of crime were criminalised under the Proceeds of Crime Act (PCA) of 1996 as money laundering. Asset confiscation and forfeiture measures were now put in place, still following international trends, to enable the state to seize ‘proceeds’ and ‘instrumentalities’ of all crime. It is generally believed that asset confiscation and forfeiture laws assist in the combating of crime by removing the benefits of crime as assets of criminal provenance are taken by government[19]. This, it is argued, may also have a deterrent effect as the primary motive for engaging in such criminal activities tends to be financial gain.

In 1998 South Africa next passed the Prevention of Organised Crime Act (POCA), consolidating and expanding South Africa’s asset confiscation and forfeiture mechanisms. In doing this, it incorporated and repealed the PCA. FICA was therefore passed in 2001 to complement these enactments of the 1990s by introducing a regulatory or administrative scheme that would enlist the assistance of the business community in detecting and combating organised crime by tracing the flow of its proceeds and confiscating them—thus depriving criminals of income that could be used to finance their somewhat lavish lifestyles and criminal ventures[20].

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[18] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf

[19] See Chapter 3 on this.

[20] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf

There is however another less widely known explanation for the enactment of South Africa's FICA business regulatory regime. This explanation is that South Africa, like many other countries, was responding to political and economic pressure mounted by some global bodies on other countries to enact the Financial Action Task Force's (FATF) global regulatory standards against money laundering. These FATF standards eventually grew to encompass counter-terrorist financing measures following the 9/11 attacks in the US. When South Africa enacted FICA, it was complying with the global FATF regime of business regulation. This may have coincided with South Africa's interests of tackling its perceived, or real, rise in its own organised crime phenomenon. The paucity of critical analysis of this political and economic pressure to adopt the FATF standards in developing countries appears, as shall be shown in this research, to deprive us of a deeper and fuller appreciation of the challenges and some seeming failures of the FICA regime in uncovering and combating money laundering.

A number of scholars have written about the country's money laundering measures aimed at combating organised crime[21]. There has also been some very important research conducted that focusses on the implementation of South Africa's AML measures, particularly within the financial sector[22]. Some of this research was completed during the course of this project. This study owes a great debt to this research. It offers an alternative and critical narrative and perspective on the origins, emergence, justification, implementation and, to an extent, enforcement of South Africa's anti-money laundering (AML) and counter-terrorist financing (CTF) measures.

[21] See De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime, Rand Afrikaans University: Johannesburg. De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime* Vol. 13(1): 26-50. Smit, P. 2001. *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Institute of Security Studies: Pretoria, Vol.51. Goredema, C, 2005. Measuring money laundering in Southern Africa. *African Security Review*, Vol. 14(4).

[22] See, for instance, G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative. CGAP. 2008. *AML/CFT Regulation: Implication for Financial Service Providers*. World Bank. CGAP. 2005. *AML/CFT Regulation: Implication for Financial Service Providers*, Washington, DC (Jennifer Isern, David Porteous, Raul Hernandez-Coss and Chinyere Egwuagu) CGAP Focus Note No. 29. CGAP .2008. *Notes on Regulation of Branchless Banking in South Africa*. CGAP Technology Program, Washington.

Louis de Koker's[23] work entitled *Money Laundering in South Africa* and Pieter Smit's[24] work entitled *Clean money, dirty source: turning organised crime against itself* are some of the early scholarly works on the FICA regulatory regime in South Africa. Smit's report was published just before FICA was introduced for deliberations in parliament. Smit advised in his work that while South Africa was not a member of the FATF and therefore not obliged to implement its standards, it was in "South Africa's own interest to take note [of the FATF standards] and to consider implementing them seriously" as FATF members assessed the "risk associated with investing" based on a country's compliance with the these standards[25].

De Koker's paper[26], published just after the passing of FICA, focussed more on mapping out South Africa's legal, regulatory and institutional framework against organised crime and money laundering. In his study[27] published in 2006 and entitled *Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion* De Koker, however, started to reflect on the challenges encountered in the implementation of Know Your Customer or Customer Due Diligence (KYC/CDD) aspects of the FATF business regulation standards. He warned that if they were not implemented cautiously, they could lead to, among other things, "financial exclusion"[28]. The KYC/CDD aspects of the regulations set requirements for documentary proof of identity and residence as a basis for providing banking services such as basic bank accounts to customers. In a developing country such as South Africa, strict KYC/CDD requirements literally meant that millions of residents would be refused access to basic banking services. This is because many of

[23] De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime, Rand Afrikaans University: Johannesburg.
[24] Smit, P. 2001. *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Institute of Security Studies: Pretoria, Vol.51, p.18.
[25] *Ibid.*
[26] De Koker, L. 2002. *Money laundering in South Africa*. Johannesburg: Centre for the Study of Economic Crime, Rand Afrikaans University.
[27] De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime* Vol. 13(1): 26-50.
[28] The concept of 'financial exclusion', for the purposes of this study, is used very narrowly to refer to legal and regulatory hindrances in accessing basic financial services such as bank accounts.

them reside in informal settlements where there are no residential postal mail services that would enable them to provide proof of address or residence documents.

This theme of financial exclusion as an unintended and undesirable consequence of implementing the FATF standards in developing countries has been picked up and increasingly researched over the past few years by such organisations as the First Initiative (which commissioned a research study that was conducted by a Johannesburg-based organisation known as Genesis Analytics)[29], the Consultative Group to Assist the Poor (CGAP)[30] and some academics, most prominently Prof. Louis De Koker and others. One of the key findings of this new research has been that implementing the KYC/CDD standards in developing countries leads to financial exclusion. This has led to a number of recommendations to guide developing countries on how they should follow a 'risk-based' approach in gradually implementing and complying with the FATF standards[31]. In following this (risk-based) approach they could minimize or possibly eliminate the unintended and undesirable consequences of these standards. What has, however, been significantly lacking in all the explanations has been the causal relationship or correlation between the manner in which developing countries adopted the FATF standards and their unintended and undesirable outcomes.

The general pattern in trying to account for and explain away these unintended and undesirable consequences has been to shift the blame to developing countries for having failed to interpret and adapt the FATF standards to their socio-economic circumstances. The Genesis study, for instance, found that all the developing countries (Indonesia, Kenya, Mexico, Pakistan and South Africa) studied in its comparative research tended initially to enact stringent KCY/CDD

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[29] G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative.

[30] CGAP. 2005. *AML/CFT Regulation: Implication for Financial Service Providers that service low income people*, Washington, DC (Jennifer Isern, David Porteous, Raul Hernandez-Coss and Chinyere Egwuagu) CGAP Focus Note No. 29.

[31] G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (authors: Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative.

requirements than they eventually implemented. According to this latter study, enacting stringent requirements was not necessary since the FATF standards were flexible for adaptation to varying socio-economic circumstances. It is important to quote this finding at some length:

> 'The study found that…the implementation of AML/CFT controls in the five countries appears to follow a similar development path. A country would set out to comply with the FATF standards by promulgating a law and regulations which are typically based on international templates rather than domestic circumstance (phase 1). As the financial supervisor and financial institutions seek to implement these controls, they would come up against capacity constraints and obstacles which either exclude or discourage clients from using formal financial services, or which tend to make it difficult for financial institutions to serve certain categories of clients (phase 2). In phase 3 regulators respond to these pressures by applying two types of adjustments: (1) existing controls are recalibrated on a risk-sensitive basis, and/or (2) sequencing the implementation of controls across sectors, transaction or entities based on the available resource envelope. This development path may repeat itself as different aspects of the AML/CFT regime are developed[32].'

This pattern found by the Genesis study on the implementation of the FATF standards in developing countries, which included South Africa, resonates closely with the pattern found by this author in South Africa[33]. However, the Genesis study does not explain why developing countries tend to adopt stricter and detrimental measures than those that are necessary given the claimed flexibility and adaptability of the standards. This omission (deliberate or not) of any explanation as to why developing countries would act so unreasonably and adopt regimes that could cause undesirable consequences to themselves is, at least, surprising. In this study we go further to offer an explanation for this implementation pattern on the part of developing countries.

[32] *Ibid.* vii
[33] See Chapter 5 and 6 below.

We explain why these countries have tended to outdo themselves, to the extent of acting against their interests, in seeking to comply with the FATF standards. We argue that it is, among other things, the manner in which the FATF standards were introduced in developing countries which led them to over-comply. It was also lack of proper guidelines from which these countries could learn how to design their local regimes in a manner that suited their circumstances.

This study traces the emergence of the AML regulatory regime from its original source, the US in the 1970s, to its subsequent spread to international and global organisations and then to incorporation in developing countries. While this study focuses on South Africa, it is comparatively informed[34] and, to an extent, seeks to generalize, where appropriate, some of the experiences of the incorporation and implementation of the regime by South Africa to other developing countries. A few scholars within the legal and international relations disciplines, particularly Reiner Hülsse[35], Daniel Drezner[36], Bosworth-Davis[37], and Jason Sharman[38] have done some admirable work in explaining the spread of the global FATF standards throughout the world and to developing countries. My own work is inspired by this literature, but goes deeper to enquire into whether or not the manner and timing of the diffusion of the global FATF standards may have had any causal influences in producing unintended consequences experienced by developing countries, particularly South Africa, in implementing the regime.

While the South African authorities might have enacted the FICA regime in order to respond to their perceived organized crime problems, there is another missed perspective which may illuminate our understanding of the regime's seeming failures to bring about or to achieve its

[34] See Vogel, M.E. 2007. *Coercion to compromise: plea bargaining, the courts, and the making of political authority* New York: Oxford University Press, p.28 on the concept of a comparatively informed historical analysis.
[35] Hülsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), pp. 155-178.
[36] Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy, 12*(5), pp. 841-859.
[37] Bosworth-Davies, R. 2006. Money laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control. 9 (4),* pp. 346-364.
[38] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), pp. 635-656.

alleged goals of detecting crime. This study brings this hidden perspective to the fore to try and enlighten our understanding and appreciation of the regime. South Africa's FICA regulatory measures were ostensibly aimed at, (as they may genuinely have been by the South African authorities,) detecting and combating money laundering were borrowed from models designed for developed countries through the FATF. Implemented as they were in South Africa, they encountered a litany of challenges that became clearer under the socio-economic conditions of developing countries. We show that instead of helping to combat crime as intended by FICA, the FATF standards of business regulation may instead, as observed by others, have the potential of exacerbating crime[39] and aggravating other old socio-economic challenges, especially for societies in transition. Below, we give some background to the global AML regime and briefly discuss its main aspects and the global efforts of the FATF to foster compliance.

Background and context

An increasing number of academics are questioning whether the complex global regime developed in the late eighties allegedly to fight the laundering of the proceeds of crime was successful or not in its goals[40]. This 'extremely expensive new regulatory order'[41] emanates, at a global level, from the FATF, an organisation established in 1989 by the G7 countries following the passing of the UN Vienna Convention Against Illicit Trade in Drugs and Psychotropic

[39] See G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative, on this point. See also De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime* Vol. 13(1): 26-50.

[40] Braithewaite, J. & Drahos, P. 2000. *Global business regulation.* Cambridge University Press: Cambridge. p106. Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*, vol. 10(1), pp.91-105. Mitsilegas, V. 2003. Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance, in *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. London: Routledge, pp.195-209.; Bosworth-Davies, R. 2007. Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp.346-364.

[41] Braithewaite, J. & Drahos, P. 2000. *Global business regulation.* Cambridge: Cambridge University Press. p106.

Substances of 1988 (Vienna Convention). The Vienna Convention introduced, for the first time at an international level, the criminalization of the laundering of proceeds of crime. The FATF was established, allegedly, to research and recommend measures to be undertaken by its members in ensuring that the financial system is not used for the purposes of laundering the proceeds of crime[42]. Despite having been established by a few countries, the FATF (has) sought to persuade all countries, even those that were not its members, to adopt and enact laws and business regulations and to promulgate new criminal justice institutions in order to achieve the main goals mentioned above.

This global initiation of crime policy seems to follow along other transnational forms of public policy in areas such as the economy, development, and environmental policy. In the case of crime, the global policies are allegedly aimed mainly at combating the illegal commercial activities associated with criminal groups (and individuals). We say allegedly throughout this work because, as this research will show, the FATF standards were primarily established for reasons other than for the combating of crime and protection of the global financial system. Criminal groups, like legitimate commercial businesses, however, have been viewed as increasingly taking an advantage of the transnational opportunities engendered by 'globalisation' to expand their national and trans-border activities[43].

Over the past two decades, countries have increasingly been pressured to shape the behaviour of their communities, including those of private businesses that are regulated for anti-money laundering purposes. This, they attempt to achieve through legislative enactments and regulatory prescriptions that attempt to control profit-driven crimes. Research and debates in various countries in Europe and elsewhere have, however, raised doubts about the efficiency and effectiveness of the global FATF standards as a means for doing so[44]. On efficiency and

[42] See FATF. 1990. *Financial Action Task Force on Money Laundering: Report 1990*. Paris: FATF Secretariat

[43] Woods, N. (2007). Global governance and the role of institutions. In *Governing globalization : power, authority and global governance.* D. Held and A. G. McGrew. Oxford: Polity pp.25-45. p.25.

[44] Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*, vol. 10(1), pp.91-105. Mitsilegas, V. 2003. Countering the

effectiveness, these debates have raised concerns about the costs and benefits of these standards. The 'cost-benefit' implications relate to the costs of implementing the regulations versus their benefits, or lack thereof, in combating crime and achieving their goal of preventing criminals from using legitimate businesses for illegal means or ends[45]. Some scholars have, for instance, argued that the costs seem to far outweigh their intended outcomes or benefits[46]. This has raised questions about the design and usefulness of these regulatory standards.

There are two tiers to this research; the global and the local. The global tier focuses on where these global standards originated, looking at their design, promotion, justification and diffusion throughout the world, especially beyond the countries that crafted them. The second tier is at a national level where they were adopted and incorporated. At this level, they are being implemented and expected to achieve their ostensible public interest goal of detecting and combating crime. The context is that of a developing country's socio-economic conditions of underdevelopment, particularly those of South Africa[47].

The FATF standards were also developed at a global level with the alleged goals of facilitating cooperation among countries on various cross-border crime problems (initially drugs). It appears however that in this quest for cooperation and policy harmonization, very little, if any, attention was paid to the varying socio-economic conditions of the countries that would later be expected to implement them. Although the FATF standards have been claimed to be flexible and adaptable to varying socio-economic conditions, the manner in which they were extended may have cancelled out their flexibility. In their development, a one-size-fits-all approach was adopted. This started with the seeming deliberate exclusion of developing countries in the development of the standards by the FATF and its principals[48]. This process, as a result, tended to assume

chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance, in *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. London: Routledge, pp. 195-209. Bosworth-Davies, R. 2007. Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp. 346-364.

[45] Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*, vol. 10(1), pp.91-105.

[46] *Ibid.*

[4747] See the research methodology section in Chapter 3.

[48] See Chapter 5 and 8 below.

homogeneity between developed and developing country socio-economic conditions, capacities and resources. In respect of developing countries, Martin Minogue has made some very important observations with regards to development agencies. He has observed that development agencies were inclined to proffer to developing countries models based on conditions and practices benchmarked on high income economies[49].

According to him, these development agencies then became frustrated when such models did not seem to work there, or received little more than ‘diplomatic lip service’[50]. Minogue then advises that three main issues should be taken into consideration in ‘transferring’ foreign generated policies to developing countries. He signals the importance of critically evaluating the weaknesses and implementation costs of these models when they are adopted and used in developing countries[51]. He further observed that these policies entail ‘a transformative conception of the state.’[52] He acknowledges that while the state in developing countries is much in need of transformation, ‘there is very little agreement on what kind of state this should be, or how such a transformation could be achieved’[53]. He then asks in this regard whether the developing state is ready for a transformation to minimalism or whether one should ‘be trying to build up its capabilities, powers and resources in order that it may achieve the developmental objectives required by its own citizens’[54]. Third, he notes that developing countries are ‘distinctively’ different in economic, social and political terms from industrialised economies[55].

He highlights variations between national cultures within these economic, social and political differences[56]. He further notes that in transferring globally generated neo-liberal policy models to developing economies, there is double transfer. Firstly, a transfer from the developed to the developing states. Secondly, there is a transfer ‘across the public-private boundary’[57]. He notes

49 Minogue, M. 2004. Public management and regulatory governance: problems of policy transfer to developing countries. in *Leading issues in competition, regulation and development*. C. K. Paul Cook, Martin Minogue, David Parker. Cheltenham, Northampton: Edward Edgar. p. 73
50 *Ibid.*
51 *Ibid.*
52 *Ibid.*
53 *Ibid.*
54 *Ibid.*
55 *Ibid.*
56 *Ibid.*
57 *Ibid.*

that many view both these types of transfers as culturally problematic and this may reflect the 'sociological naiveté' of those who promote them as they ignore or conflict with social and political dynamics of public service organisations and systems in developing countries[58].

In this study we take into account this advice from Minogue and other scholars[59] in trying to analyse the incorporation of the FATF standards in developing countries. We ask if they have really been implemented or have they received nothing more than 'diplomatic lip service', especially given the clearly coercive manner in which they were disseminated to these countries[60]. We note that the FATF standards, as discussed above, were primarily designed for implementation in developed countries and it may be important critically to evaluate their weaknesses and their cost implications when implementing them in later developing countries. We therefore try to ascertain whether the adoption of these standards has had any positive impact in the fight against crime in these countries or not, especially as evidence seems to suggest that they have not done so in the originating developed countries[61].

In the case of the double transfer, from developed to developing countries traverses the public-private boundaries of governance, what is traditionally the role of law enforcement (criminal investigations) is made a responsibility of regulated private businesses. Such enterprises must, on a daily basis, monitor the behaviour of their customers for the purposes of detecting crime. This happens at a cost that regulated businesses must recover from somewhere, typically from consumers[62].

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[58] *Ibid.*

[59] See, for instance, Minogue, M. & Cariño, L.V. 2006. *Regulatory governance in developing countries.* Cheltenham: Edward Elgar.

[60] See below and Chapter 5 regarding the manner in which the FATF standards were diffused to developing countries.

[61] See Chapter 6 and 7 below.

[62] See discussion on this in Chapter 2

In conjunction with these considerations, one must also take into account the latest and most complex developments in global governance as articulated by various scholars[63]. For instance, it has been said that states are increasingly resorting to multilateral cooperation, propelled by globalization, in order to try and find mutually beneficial solutions to transnational socio-economic issues[64]. As we acknowledge this resort to multilateralism, it is also important to acknowledge and consider that it is influenced by a plethora of conflicting interests and power disparities between the rich and powerful states, on the one hand, and the developing and less powerful ones, on the other[65]. This imbalance of forces normally finds expression in global policy outcomes where the interests of the powerful states tend to overshadow and take priority over those of smaller or less powerful states.

For instance, evidence presented in this study casts some doubt on the public interest goals that have been popularly advanced as the motives for the establishment of the FATF and its standards. This evidence offers a plausible alternative explanation which suggests that the FATF standards did not merely emerge in order to assist in detecting crime and to protect the global financial system from abuse/misuse by criminals. They may appear, instead, to have emerged to "govern through crime"[66] some narrower competition and regulatory arbitrage[67] issues of concern for certain Western countries that instigated the diffusion of the FATF standards throughout the world. That the global FATF standards could also be claimed to assist in combating crime may simply have been a political convenience. The crime rhetoric that was used to promote the regime globally may therefore have been employed primarily to govern some pressing issues of competition and arbitrage.

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[63] See, for instance, Woods, N. (2007). Global governance and the role of institutions. In *Governing globalization: power, authority and global governance.* D. Held and A. G. McGrew. Oxford: Polity, pp. 25-45. Duffield, M. R. 2001. *Global governance and the new wars: the merging of development and security*. London: Zed Books.

[64] Woods, N. (2007). Global governance and the role of institutions. In *Governing globalization: power, authority and global governance.* D. Held and A. G. McGrew. Polity**:** Oxford, pp. 25-45.

[65] *Ibid.*

[66] See Simons, J. 2007 *Governing through crime: how the war on crime transformed American democracy and created a culture of fear*. Oxford University Press.

[67] See Chapter 5. See also Bosworth-Davies, R. 2007. Money Laundering: towards an alternative interpretation- chapter two. *Journal of Money Laundering Control,* pp. 346-364

While the global measures to fight money laundering emerged through the adoption of the Vienna Convention, they have primarily been led by the FATF, a transnational 'non-state' body. The FATF is widely acknowledged for having played a significant role in diffusing the AML regime and developing, in this process, a complex network of similar transnational non-treaty-based or non-convention-based organisations. Under the leadership of the FATF, more than 170 countries and territories are reported to have adopted the FATF standards of business regulation[68]. A question must be asked as to whether many countries adopted these standards as a result of voluntary policy learning or as a result of other forces that were at play[69]. It is readily understandable that FATF members adopted and implemented standards proposed by a body that they established in their interest. As to how and why the many countries who were not part of the original scheme converged and adopted the regime becomes interesting in light of the known coercive strategies that were deployed by the FATF in introducing the regime to non-member countries that were named, shamed and blacklisted as Non-Cooperating Countries and Territories (NCCTs) at the turn of the century[70].

It is important to ask and find answers to this question as it has implications for the legitimacy of the FATF, as an organization, and its standards, an issue that we discuss in depth in Chapter 8. We now turn to a description of the global AML regime, starting with the UN Convention Against Illicit Trade in Narcotic Drugs and Psychotropic Substances of 1988 before going on to introduce the FATF and the global efforts set in motion to try and spread the regime throughout the world. We then conclude this introduction by discussing the purposes of this study, the research questions pursued and the hypotheses that guide it.

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[68] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), pp. 635-656

[69] *Ibid.*

[70] See later below

United Nations 'hard law'

The global regulation of money laundering started earnestly in 1988, with the signing of the Vienna Convention. While there are UN conventions that predate the Vienna Convention on illicit drugs, these did not focus on the proceeds of crime. These old UN conventions include the *Opium Protocol of 1953*, the *Single Convention on Narcotic Drugs of 1961* and the *Convention of Psychotropic Substances of 1971*. Other conventions predate the UN. These include the *Hague International Opium Convention of 1912*, the League of Nation's *Second Opium Convention of 1925*, the *Convention for Limiting the Manufacture and Regulating the Distribution of Narcotic Drugs of 1931*, the *Convention for the Suppression of the Illicit Traffic in Dangerous Drugs of 1936*[71]. All these international conventions attest to the fact that international illicit drugs trafficking and sales issues are old. In recent decades they have evolved to accommodate new prevention measures focusing on drug proceeds. New strategies are embodied in the Vienna Convention which added the dynamic of attacking the proceeds made from drug-related crime.

The preamble of the Vienna Convention noted the extent to which drug-related crime had assumed a transnational character, generating "large financial profits and wealth enabling transnational criminal organizations to penetrate, contaminate and corrupt the structures of government, legitimate commercial and financial business, and society at all its levels"[72]. One of the main methods of fighting drug related crime was, according to the Vienna Convention, "to deprive persons engaged in illicit traffic of proceeds of their criminal activities and thereby eliminate their main incentive for doing so"[73]. The articles of the Vienna Convention required signatories to make legislative enactments in their domestic laws which would enable cooperation between countries in the form of mutual legal assistance (MLAs) and extradition of offenders[74]. It

[71] See Chalwa, S., Pietscmann, T. 2005. Drug trafficking as a transnational crime. In *Handbook of transnational crime and justice*. P. Reichel. (ed.), London: Sage Publications.
[72] UN 1988 *United Nations Convention Against Illicit Trade in Narcotic Drugs and Psychotropic Substances of 1998: Vienna Convention.* p.1.
[73] *Ibid.*
[74] See *Ibid.*

also required the participating countries to criminalise the laundering of the proceeds of drug-related crimes and to enact legislation to provide for confiscation or seizure of proceeds of drug-related offences. It came into force in 1990 and is the foremost international convention on money laundering control[75]. As of 2004, 168 countries had signed and ratified the Vienna Convention[76].

After the Vienna Convention, there have been several other UN conventions, protocols and resolutions that have emphasized money laundering control as a primary strategy to tackle crime. These include: the *UN Convention Against Transnational Organised Crime of 2000* (or Palermo Convention)[77], the *UN International Convention for the Suppression of the Financing of Terrorism of 1999* which entered into force in April 2002, and the *UN Convention against Corruption of 2003*, which came to effect in 2005. The common factor in all these international conventions is that they emphasise the criminalization, confiscation and forfeiture of proceeds of crime as one of the primary methods of fighting transnational crime. They also make certain offences 'predicate offences' of money laundering. This means that money laundering is a secondary offence which derives from the occurrence of other primary offences[78]. Before it can take place, these other offences such as corruption, fraud, illicit dealing or trafficking in narcotic drugs or many other offences should have taken place[79]. Money laundering is therefore a derivative offence. It derives its occurrence or execution from other primary crimes.

As a criminal offence, it may be committed by others than the principals or co-principals who engage in the primary offences. It also can be committed by those who assist or collude, intentionally or through omission or negligence, with these principals, to launder the proceeds of

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75 Joyce, E. 2005. Expanding the international regime on money laundering in reponse to transnational organised crime, terrorism and corruption. In *Handbook of transnational crime and justice*. P. Reichel. (ed.) London: Sage Publications, pp. 79-97.
76 *Ibid.* p.86.
77 The Palermo Convention of 2000 is supplemented by a number of protocols, including the *Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children*; the *Protocol against the Smuggling of Migrants by Land, Air, and Sea*; and the *Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition.*
78 See Lilley, P. 2003. *Dirty dealing: the untold truth about global money laundering, international crime and terrorism.* London: Kogan Page.
79 *Ibid*.

crime[80]. Money-laundering is defined as a method through which criminals disguise the origins of illegally obtained capital or income in order to use or benefit from it without raising the suspicions of law enforcement[81]. Money laundering, therefore, basically refers to the various strategies and techniques[82] that criminals use to disguise the criminal provenance of their assets in order to avoid prosecution and imprisonment for the offences from which they have derived them. With money laundering criminalized, benefits (financial or otherwise) accruing from the commission of any predicate offence become proceeds of crime. In order to avoid detection, the reasoning goes, perpetrators would disguise the origins of these benefits by laundering them. As noted by the United Kingdom Threats Assessment of 2003:

> "Since their [organised criminals] activities are driven either directly or indirectly by the desire to make money, most serious and organised criminals look for ways to secure and safeguard the proceeds of their criminal ventures… Money may be banked or spent on valuable assets or a lavish lifestyle. Much of it may be used to fund further criminal activities, financing illicit trades, paying off associates and increasing the power and influence of individual criminals and groups…and tackling money laundering is fundamental to combating serious and organised crime"[83].

The UN Conventions that are cited above emphasise the focus on money laundering control as central to preventing and detecting organized, revenue-generating, crimes. They further emphasise seizure and forfeiture of these proceeds as a disincentive for committing crime or as a

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80 *Ibid.*

81 Ibid. Ashe, T.M. & Reid, P.L.L.M. 2000. *Money laundering: risks and liabilities*. Dublin: Round Hall Sweet & Maxwell. Hinterseer, K. 2002. *Criminal finance: the political economy of money laundering in a comparative legal context*. The Hague: Kluwer Law International. Ehrenfeld, R. 1992. *Evil money: encounters along the money trail*. New York: Harper Business. Levi, M. 1991. Regulating money laundering: the death of bank secrecy in the UK. *British Journal of Criminology,* Vol. 31(2), pp. 109-125.

82 See Hinterseer, K. 2002. *Criminal finance: the political economy of money laundering in a comparative legal context*. The Hague: Kluwer Law International. pp1-38 for various methods and processes of money laundering.

83 NCIS. 2003. *United Kingdom Threat Assessment of Serious and Organised Crime 2003*. Crime Threat Assessment. London: National Criminal Intelligence Service. p.53

means of denying criminals and terrorists access to financial resources that enable them to flourish or execute their plans, respectively[84]. The conventions also highlight interstate cooperation through mutual legal assistance and extradition, information-sharing, and harmonisation of systems and laws in order to facilitate better cooperation between countries. Another aspect is the new regulatory role that the implementing jurisdictions require of private financial and non-financial designated businesses. The most co-ordinated and detailed global initiative is laid out in the form of the FATF standards known as the FATF 40+9 Recommendations, to which we now turn.

Financial Action Task Force's 'soft law' standards

On the heels of the Vienna Convention of 1988, in 1989, the 'G7', which includes the heads of governments of the United States, United Kingdom, France, Japan, Germany, Italy and Canada, and the President of the European Commission, established an *ad hoc* non-statutorily-based body known as the FATF[85]. The formation of the FATF was motivated, according to the G7, on the realisation that 'the drug problem' had reached 'devastating proportions' and 'demanded urgent and decisive actions, both on a national and international basis'[86]. The objectives of the FATF were to evaluate both national and international measures being used to fight the problem of drugs[87]. It would also advise on how such measures could be enhanced in order to contain the problem of drug-related offences[88].

The 40+9 Recommendations are a detailed list of standards that FATF members and other interested countries are encouraged to adopt and implement within their national jurisdictions. In 1996, 2001 and 2003 these standards were revised, according to the FATF, to accommodate new

[84] See UN 1999 *International Convention for the Suppression of the Financing of Terrorism of 1999*, UN 2000 *United Nations Convention Against Organised Crime of 2000*: Parlemo Convention., UN 2003 *United Nations Convention Against Corruption of 2003*.
[85] FATF. 1990. *Financial Action Task Force on Money Laundering: Report 1990*. Paris: FATF Secretariat.
[86] *Ibid.* p.3
[87] *Ibid.*
[88] *Ibid.*

criminal trends and laundering techniques. Over these years money laundering grew to become a secondary offence of not only drugs, as was originally envisaged in the formation of the FATF and the Vienna Convention in the late 1980s. It has gone on to become a predicate offence of virtually all revenue-generating crime and also of terrorist financing. Consequently, the reach of the regulatory recommendations is no longer limited to banking institutions as was the case initially, but covers instead many other financial and non-financial institutions. At the outset, the FATF focused on the use of financial institutions alone, especially banks, as vehicles for money laundering. However growing numbers of studies on money laundering techniques and typologies produced evidence that many other institutions besides banks were being used or were potentially vulnerable for laundering crime proceeds. For instance, attorneys, estate agents and securities brokers, among others, were cited as being used by criminals to facilitate money laundering based on the services they offer. Criminals could use estate agents to buy property, therefore transforming dirty money, perhaps earned through illicit drug dealing, into real estate which could later be sold for cash, disguising any obvious connection to criminal provenance or underlying offences of the now apparently legitimate money from the sale.

The FATF standards have therefore continuously been extended in reach. All countries have continuously been encouraged by the FATF to update their anti-money laundering systems. The FATF standards can be divided into five broad categories. The first is based on criminal law and encourages countries to criminalise the laundering of the proceeds of crime and the financing of terrorism. As noted earlier, the criminalisation of money laundering is based on a number of premises. It is reasoned that many criminals commit profit-driven crimes for purposes of financial gain. The major concern, therefore, has been that through laundering the proceeds of their illegal activities, criminals open the way to enjoy the fruits of their crimes and this should be prohibited through criminalising money laundering.

Linked to this is a second category of the FATF standards, which requires countries to promulgate legislation that would enable law enforcement agencies to confiscate and require criminals to forfeit proceeds or instrumentalities of crime, with the aim of removing incentives or facilitators of crime.[89]. The reasoning behind asset confiscation and forfeiture is not only to send a message that 'crime does not pay', but also to prevent criminals from reinvesting in subsequent crimes[90]. Asset confiscation and forfeiture carries some crime-prevention undertones but the actual procedures are grounded in civil law. In response to asset forfeiture requirements, a number of countries have enacted laws and formed institutions known as asset recovery or forfeiture agencies. Contemporary laws that facilitate the confiscation of such assets have been of two types-- *in personam* and *in rem* procedures[91].

The *in personam* procedures require an individual to be charged with a criminal offence and proven guilty 'beyond a reasonable doubt', before the criminally derived assets are confiscated[92]. The *in rem* procedures allow for assets to be forfeit if it can be established, on the balance of probabilities, that they are proceeds or were concerned in or instrumental in the commission of a crime[93]. On the one hand, the *in personam* confiscation procedures, according to Naylor, provide standard safeguards in relation to the presumption of innocence, the right to counsel, and protection against double jeopardy or disproportionate punishment[94]. On the other hand, the *in rem* procedures allow for assets to be frozen in advance of a trial and forfeit even where there is no criminal case or an accused person but only on determination that on the balance of probabilities such property was likely to be the proceeds of a crime or an instrumentality of an offence[95]. The *in personam* procedures therefore are conviction-based while the *in rem* are non-conviction-based[96].

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89 *Ibid.* See recommendation 3.
90 NCIS. 2003. *United Kingdom Threat Assessment of Serious and Organised Crime 2003*. Crime Threat Assessment. London: National Criminal Intelligence Service, p. 53.
91 Naylor, R. T. (2003). Follow-the-money methods in crime control policy. in *Critical reflections on transnational organised crime, money laundering, and corruption*. M. E. Beare. (ed), Toronto: University of Toronto Press**.,** page 257.
92 *Ibid.*
93 *Ibid.*
94 *Ibid.*
95 *Ibid.*
96 See Chapter 4 for more discussion on this where we discuss South Africa's legal framework for asset confiscation and forfeiture laws.

The third and seemingly one of the most controversial categories of the FATF standards addresses the ways in which money laundering could be minimised or curbed. These recommendations require countries to enact enabling legislation and regimes that regulate various types of private businesses. The businesses are regulated on the basis that they are vulnerable to misuse by criminals to launder crime proceeds. At the moment we can only offer, as an illustration, a preliminary summary of the regulatory regime on businesses as a thorough discussion and analysis follows in Chapters 4, 6 and 7. The business regulatory standards of the FATF require countries to regulate, primarily, banks but also other businesses to implement what is known as 'customer due diligence' (CDD), which is also popularly known as "Know Your Customer" (KYC). KYC/CDD requires regulated businesses to profile their customers.

This profiling of customers is believed to enable regulated businesses to monitor and report customer transactions, which they believe to be suspicious or unusual, to law enforcement authorities-- particularly to the so called Financial Intelligence Units. KYC/CDD requirements further demand that regulated businesses train their employees on how to fulfil their regulatory duties of money laundering control and to keep records of transactions and other customer information for extended mandatory periods of time. The institutions are also required to develop internal anti-money laundering control measures and to appoint what is referred to as Anti-Money Laundering Reporting Officers (AMLROs), who are basically compliance officers that deal with anti-money laundering compliance issues[97]. These regulatory requirements, in some countries, are accompanied by tough criminal sanctions in the form of fines and custodial sentences against employees who fail to perform their AML duties. These criminal sanctions make money laundering not only an offence that is committed by criminals when they launder their proceeds, but also an offence that can, as discussed above, be committed through complicity by regulated businesses or their employees when they fail to perform their regulatory duties.

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[97] See recommendations 4-25 of FATF. 2003. *The Forty Recommendations: incorporating the amendments of 24 October 2004*. FATF Recommendations, Paris: FATF Secretariat, OECD.

The fourth broad set of the FATF standards require countries to make legislative provisions for the establishment of what is referred to as Financial Intelligence Units (FIUs)[98]. FIUs are new state institutions in the history of criminal justice and are established by governments to receive, analyse and disseminate financial information or intelligence that can be used to detect or combat money laundering[99]. At the time of writing, there were about 120 countries that had established FIUs based on the recommendations of the FATF[100]. In support of this initiative, the World Bank and the IMF, together with the FATF, have provided technical assistance to many countries in establishing their FIUs[101]. FIUs are custodians of very sensitive personal financial information reported or acquired by them from the regulated businesses. They disseminate this information to designated law enforcement agencies (LEAs). It is held that these reports help LEAs to investigate and solve crime. We cover this aspect of the anti-money laundering regime in *Chapter 7* below.

While these FIUs have existed for some time now, there is not much scholarly work on them. Evaluations conducted by the IMF and the World Bank have generally concentrated on whether or not countries have established them, with a view of encouraging them to[102]. More about how they operate, their powers and the implementation challenges, effectiveness and efficiency still beckons for study by scholars. A non-statutory inter-governmental body known as the Egmont Group of Financial Intelligence Units was established in 1995[103]. The Egmont Group's main goal has been 'to create a global network by promoting international cooperation between FIUs'[104]. It is the first international body to have been established directly as a consequence of the operational work of the FATF. The Egmont Group members are the FIUs of countries[105].

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[98] See Recommendations 26 to 34, *ibid.*
[99] *The Egmont Group of FIUs Annual Report: May 2007-June 2008*. The Egmont Group Secretariat: Toronto
[100] *Ibid.*
[101] Sathye, M. & Patel, C. 2007. Developing financial intelligence: an assessment of the FIUs in Australia and India. *Journal of Money Laundering Control,* Vol. 10 (4), pp. 391-405, p.392
[102] *Ibid.*
[103] *The Egmont Group of FIUs Annual Report: May 2007-June 2008*.. Toronto: The Egmont Group Secretariat.
[104] *Ibid.*
[105] See *Ibid.*

The final broad category of the FATF standards requires governments to enact legislation that will enable and encourage transnational cooperation between governments. The reasoning here is that many organised crime groups have taken advantage of globalisation and, as a result, operate transnationally. This, some argue, has enabled criminals to operate advantageously and with limited restriction, especially where law enforcement authorities are limited by jurisdictional boundaries. As a result, the FATF recommended that countries should harmonise their crime fighting laws, policies and systems to facilitate cooperation. This had to be done through what is referred to as mutual legal assistance (with regard to extra-territorial sharing of crime information and collection of evidence) and extradition treaties (which involve the extraterritorial exchange of suspects/accused persons). Issues of mutual legal assistance and extradition have their own complicated judicial procedures which must be followed[106]. As a result of these FATF recommendations and the UN conventions on crime, many states have had to establish and/or update their mutual legal agreements and extradition treaties. However the extent to which they have done that and the extent to which such assistance mechanisms are utilised in transnational crime matters is a research topic in its own right and is beyond the remit of this study.

The FATF standards, as already noted, are widely regarded as international 'best practice' standards. They have received support from a variety of international organisations such as the World Bank, the IMF, the UN, the Basel Committee on Banking Supervision, among others. All these organisations have continuously encouraged the national adoption and implementation of the FATF standards. The FATF standards and work have also led to the creation of a network of organisations whose primary objectives are to fight crime at a transnational level. These include, as discussed above, such groups as the Egmont Group, the Wolfsburg Group and several FATF style regional bodies (known as FSRBs). The Wolfsburg Group was formed in 2000 through an

[106] Joutsen, M. 2005. International cooperation against transnational organised crime: extradition and mutual legal assistance in criminal matters. in *Handbook of transnational crime and justice*. P. Reichel (eds.). London: Sage Publications**.** pp. 255-274.

association of 12 global banks[107]. The aims of the Wolfsburg Group are "to develop financial services industry standards…for Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies"[108]. The FATF-Style Regional Bodies (FSRBs) are mainly made up of countries which are not full members of the FATF[109]. There are currently eight FSRBs[110] which include more than 140 countries as members[111].

All member-states of the FATF who are geographically located in the regional jurisdictions of the FSRBs concerned are also members of these regional bodies (FSRBs)[112]. The FSRBs and other international organisations can hold different kinds of membership status within the FATF; some are 'associate members' and some 'observer members'[113]. For instance, South Africa is both a member of the FATF and of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). Four FSRBs, the Asia/Pacific Group on Money Laundering (APG), the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL), Financial Action Task Force on Money Laundering in South America (GAFISUD) and the Middle East and North Africa Financial Action Task Force (MENEFATF) are 'associate members' of the FATF.

The other remaining FSRBs, the Caribbean Financial Action Task Force (CFATF), Eurasian Group (EAG), Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), and the Inter-governmental Action Group against Money Laundering in Africa

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[107] The members of the Wolfsburg Group are, (1) ABN Amro Bank NV, (2) Bank of Tokyo Mitsubishi Ltd, (3) Barclays Bank, (4) Citigroup, (5) Credit Suisse Group, (6) Deutsche Bank AG, (7) Goldman Sachs, (8) HSBC, (9) JP Morgan Private Bank, (10) Santander Central Hispano, (11) Societe General, and (12) UBS AG. Retrieved from www.wolfsburg–principles.com

[108] The Wolfsburg Group (2007) Retrieved from www.wolfsburg–principles.com,

[109] FATF. 2006. *Annual Report 2005-2006*. Paris: FATF Secretariat, OECD.

[110] The list of FSBRs is as follows: (1) Asia/Pacific Group on Money Laundering (APG), (2) Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (MONEYVAL), (3) Financial Action Task Force on Money Laundering in South America (GAFISUD), (4) Middle East and North Africa Financial Action Task Force (MENEFATF), (5) Caribbean Financial Action Task Force (CFATF), (6) Eurasian Group (EAG), (7) Eastern and Southern Africa Anti-Money Laundering Group, (8) Intergovernmental Action Group against Money Laundering in Africa (GIABA). See *Ibid.*

[111] *Ibid.*

[112] *Ibid.*

[113] *Ibid.*

(GIABA) are 'observer members'. There are several other international organisations[114] which are 'observer members' such as the African Development Bank, Asian Development Bank, European Central Bank, World Bank and the International Monetary Fund. The FATF regards the FSBRs as partners who play 'important leadership roles in their respective regions' and who 'constitute a global network against money laundering and terrorist financing'[115]. According to the FATF, the FSRBs consist of member countries that have committed themselves to implementing the 40+9 Recommendations and have agreed to undergo 'mutual evaluations' (see discussion later) of their AML/CFT systems[116].

With this brief background, it is clear that a complex global network and a set of both public and private policy initiatives presently exist to fight various transnational crimes. It focuses on a central strategy of attacking the proceeds and instrumentalities of crime. Below we look at attempts to implement these policies by the UN and the FATF. In doing this we also look at some critiques of this complex global system.

Some global implementation efforts and debates

As discussed above, the UN has been responsible for the development of a number of conventions and protocols. On the other hand the FATF has sought to articulate these through its recommendations. In so doing, it has added the business regulatory aspects and, later, the establishment of FIUs. We turn now to introduce the attempts to implement these measures. One

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[114] The International observer organisations are; (1) African Development Bank, (2) Asian Development Bank, (3) Commonwealth Secretariat, (4) Egmont Group of Financial Intelligence Units, (5) European Bank for Reconstruction and Development, (7) European Central Bank, (8) Europol, (9) Inter-American Development Bank, (10) International Association of Insurance Supervisors, (11) International Monetary Fund, (12) International Organisation of Securities Commissions, (13) Interpol, (14) Organisation of American States/Inter-American Committee Against Terrorism, (16) Organisation of American States/Inter-American Drug Abuse Control Commission, (17) Organisation for Economic Co-operation and Development, (18) Offshore Group of Banking Supervisors, (19) UN Office on Drugs and Crime, (20) UN Counter-Terrorism Committee of the Security Council, (21) World Bank and the (22)World Customs Organisation. See FATF. 2007. *Annual Report 2006-2007*. Paris: FATF Secretariat, OECD.
[115] FATF. 2007. *Annual Report 2006-2007*. Paris: FATF Secretariat, OECD.p.2
[116] *Ibid.*

of the UN's main role here has been the development of international law through conventions which member-states ratify or accede to voluntarily. They then become legally bound to implement and comply with these conventions. However, member-states may choose to not sign or ratify these conventions and protocols. This would leave them with no obligation to implement or comply. Even after signing such conventions, member-states can still withdraw their participation by notifying the United Nations of such withdrawal.

Through the United Nations Office on Drugs and Crime (hereafter UNODC), the UN has played a major role in promoting the ratification of the UN conventions and protocols through conferences, workshops and other means[117]. To encourage implementation, the UN has provided technical assistance to the signatory member-states on issues of legislative drafting and in updating and reviewing the implementation of such conventions. Other efforts of UNODC have included the training for law enforcement officials, producing and providing manuals and guidelines, encouraging signatory members to conduct self-assessments and to submit reports on their implementation efforts, initiating and running capacity building programs in regions that need assistance, and conducting research[118]. According to the UN there are 140 and 108 member-states that have, respectively, signed and ratified the UN Convention against Corruption, 139 have ratified the Convention on Transnational Organised Crime, and 108 have ratified the Vienna Convention on Drugs[119].

The FATF (which is central to this study), on the other hand, has used some innovative and controversial means to drive implementation of its recommendations. But before we look at them, we look at the work that is done by the FATF as such work seems to be linked to the nature of its implementation efforts. There are three main activities that the FATF has been involved in besides formulating and revising the recommendations. The first is what the FATF refers to as 'mutual

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[117] UN. 2008. *International cooperation in combating transnational organised crime and corruption. Commission on Crime Prevention and Criminal Justice*. Economic and Social Council: United Nations. p.5.
[118] *Ibid.*
[119] *Ibid.*

evaluation'. This is a peer review mechanism which enables the FATF to 'assess the overall effectiveness of AML/CFT systems' of its members, evaluating whether the 'necessary laws, regulations or other measures required are in force and effect'[120]. To do this, it follows a methodology known as the FATF's *AML/CFT Methodology of 2004.* This methodology is also used by the FSRBs to evaluate the members in their regions[121]. According to the FATF mutual evaluations are conducted by a team of 'four to six selected experts in the legal, financial and law enforcement fields from other member governments, with up to two members of the FATF Secretariat' and takes approximately ten months to a year to complete [122]. After an evaluation, a report is compiled. These reports, among other things, highlight areas for improvement[123]. They are also published after their formal adoption by the FATF plenary meetings, which are the decision-making forum of the 36 full-time members of the FATF[124].

A considerable number of mutual evaluations are also conducted or led by the World Bank and the IMF, in collaboration with the FATF and the FSRBs, using the FATF's *AML/CFT Methodology of 2004*[125]. Some scholars argue that this mutual evaluation process puts considerable moral and political pressure on governments that are in non-compliance with the FATF standards[126]. The World Bank and IMF are also known to be using the outcomes of these mutual evaluations as a criterion of conditionality in extending their loans and financial assistance to their clients[127]. The clients of these institutions have largely been developing countries. Such countries are therefore being pressurised to implement these standards, whether or not they are signatories, as they have now been made part of good governance measures[128].

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[120] FATF. 2007. *Annual Report 2006-2007*. Paris: FATF Secretariat, OECD. p. 4
[121] *Ibid.*
[122] *Ibid.*
[123] *Ibid.*
[124] *Ibid.* p. 5
[125] I*bid.*
[126] Williams, P. & Baudin-O'Hayon, G. 2007. Organised crime and money laundering. in *Governing globalization : power, authority and global governance*. D. Held and A. G. McGrew. Oxford: Polity**,** pp.127-144.
[127] See Alexander, K., R. Dhumale, et al. (2006). Global governance of financial systems : the international regulation of systemic risk. New York ; Oxford: Oxford University Press.
[128] Williams, P. & Baudin-O'Hayon, G. 2007. Organised crime and money laundering. in *Governing globalization : power, authority and global governance*. D. Held and A. G. McGrew. Oxford,:Polity**,** pp**.**127-144..

Another key activity of the FATF is its review of the techniques, trends and typologies of money laundering and development of suggested ways of addressing them. This activity has culminated in a number of reports and the updating of its recommendations based on their findings. At the time of this writing, there were more than 16 typologies reports that had been published on a yearly basis since 1995 to be used in enhancing FATF standards in keeping with new crime trends. These reports are compiled by experts who sit on or are commissioned by the FATF's Working Group on Typologies (WGTYP).

The third and most controversial work of the FATF is that on Non-Cooperating Countries and Territories (NCCT) which it started in year 2000. The NCCTs were those countries and territories the FATF assessed between 2000 and 2003 and judged not to meet its standards. Between 2000 and 2003, the FATF published a blacklist of 23 such countries[129]. These countries were removed from the list once they implemented or made efforts to comply with its recommendations. There was an annual review process to determine which countries and territories had made progress in complying[130]. By 2007, no countries or territories remained on the FATF blacklist, indicating that all the blacklisted countries had made progress in implementing the FATF standards[131]. However, the FATF continuously monitors countries and publishes warnings on those it deems to be failing to meet its standards. Some such warnings were published

[129] Bahamas, Cayman Islands, Israel, Liechtenstein, Nauru, Panama, Philippines, Russia, St. Kitts and Nevis, Egypt, Guatemala, Hungary, Indonesia, Myanmar, Nigeria, Dominica, Cook Island, Lebanon, Nuie, St.Vincent and Grenadines, Marshall Island, Grenada, and Ukraine. See FATF. 2006. *Annual Report 2005-2006*. Paris: FATF Secretariat, OECD.

[130] See FATF. 2000. *Review to identify non-cooperative countries and territories: increasing the worldwide effectiveness of anti-money laundering measures.* FATF Secretariat, OECD: Paris. FATF. 2001. *Review to identify non-cooperative countries and territories: increasing the worldwide effectiveness of anti-money laundering measures.* Paris: FATF Secretariat, OECD. FATF. 2002. *Review to identify non-cooperative countries and territories: increasing the worldwide effectiveness of anti-money laundering measures.* NCCT Reviews. Paris: FATF Secretariat, OECD. FATF. 2003. *Annual review on non-co-operative countries and territories.* NCCT Reviews. Paris: FATF Secretariat, OECD. FATF. 2004. *Annual review on non-co-operative countries and territories.* NCCT Reviews. Paris: FATF Secretariat, OECD. FATF. 2005. *Annual and overall review on non-co-operative countries and territories.* NCCT Reviews. Paris: FATF Secretariat, OECD. FATF. 2006. *Annual review on non-cooperating countries and territories 2005-2006*. NCCT Reviews. Paris: FATF Secretariat, OECD., FATF. 2007. *Annual review on non-cooperating countries and territories 2006-2007*. NCCT Reviews. Paris: FATF Secretariat, OECD.

[131] FATF. 2007. *Annual review on non-cooperating countries and territories 2006-2007*. NCCT Reviews. Paris: FATF Secretariat, OECD.

in its February 2008 Public Statement where several countries including Iran, Uzbekistan, Turkmenistan, Pakistan, Cyprus, and Sao Tome and Principe were named[132].

The NCCT blacklists, which were basically a 'naming and shaming' tool, raised issues of legitimacy and accountability concerning the FATF. Some have viewed the NCCT process as arbitrary and illegitimate since it targeted countries that were not members of the FATF[133]. Bosworth-Davis[134] has described the FATF as a 'gentleman's club' questioning its legitimacy as a body with no international convention-based status, not enshrined in statute, and with an 'exclusive' and therefore non-democratic membership. To the extent this is true, it means that the FATF is a non-legally mandated body under international law. He further notes that the FATF's staff is non-elected and made up solely of career civil servants from its member states, with no representatives from the regulated businesses affected by its recommendations. On the same issues of legitimacy, Mitsilegas points out that one particularly controversial issue about the FATF's and its work is that it

> "...represents the interests of the developed world and thus its policies may fail to take into account the specific needs of countries outside this club. The unilateral imposition and evaluation of standards by an *ad hoc* body differs significantly from negotiations and agreement of sovereign states within the auspices of an international organisation…FATF standards are not only linked with the formation of economic policy, but have major implications for the receiving countries' legal

[132] FATF. 2008. FATF Statement. 28 February 2008. https://www.fatf-gafi.org/dataoecd/16/26/40181037.pdf

[133] See Bosworth-Davies, R. 2006. Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp.346-364. Mitsilegas, V. 2003. Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance. In *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. (eds) London: Routledge**.** pp. 195-209. See also Joyce, E. 2005. Expanding the international regime on money laundering in response to transnational organised crime, terrorism and corruption. in *Handbook of transnational crime and justice*. P. Reichel. (ed) London: Sage Publications**,** pp. 79-97.

[134] Bosworth-Davies, R. (2006). Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*: 346-364. p.348.

> systems, which have to implement guidelines that may still be controversial in the exporting countries." [135]

FATF's work on NCCTs has culminated in various theories regarding its strategies to ensure compliance, especially with countries which were not its members. Some academics have argued that the blacklisted countries had not complied with the FATF standards voluntarily, but only subsequently through coercive means which involved naming and shaming and sometimes threats of economic sanctions[136]. Blacklisted countries were forced to comply with this externally imposed regime in order to regain their original status[137]. For instance, in its 2006 report on NCCTs the FATF removed two countries that were still on its blacklist, Nauru and Nigeria, and expressed satisfaction with their progress[138]. Nauru had abolished its 400 shell banks, which were viewed as a 'money laundering risk' by the FATF and Nigeria had implemented the regulatory reforms[139].

The NCCT reports carried some serious warnings which were widely publicised in the media and on the FATF's internet website detailing alleged weaknesses the FATF's assessments had identified within the blacklisted countries. Proposals were also advanced on what they needed to do to address these shortcomings. For instance, in its report, the FATF would list the countries that were non-compliant and then issued a warning. One of the alerts read as follows:

> "The FATF calls on its members to update their advisories requesting that their financial institutions give special attention to businesses and transactions with

135 Mitsilegas, V. 2003. Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance. In *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. (eds.) London: Routledge**.** pp. 195-209. p. 209.

136 Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy*, *12*(5), pp. 841-859.p. 852. Sathye, M. & Patel, C. 2007. Developing financial intelligence: an assessment of the FIUs in Australia and India. *Journal of Money Laundering Control,*Vol 10 (4), pp. 391-405, p. 39. Hülsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society*, *21*(2), pp.155-178, p.167

137 Hülsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society*, *21*(2), pp.155-178, p. 167

138 FATF. 2006. *Annual review on non-cooperating countries and territories 2005-2006*. NCCT Reviews. Paris:FATF Secretariat, OECD.

139 *Ibid.*

> persons, including companies and financial institutions, in those countries or territories identified in the report as being non-cooperative"[140].

Further, it warned the blacklisted countries,

> "Should those countries or territories identified as non-cooperative maintain their detrimental rules and practices despite having been encouraged to make certain reforms, FATF members would need to consider the adoption of counter-measures against such jurisdictions"[141].

These apparent threats have been backed by the G7 countries[142], which issued similar warnings backing the FATF[143]. The Finance Ministers of the G7, a forum representing some of the richest countries in the world, issued a warning as follows:

> "We are prepared to act together when required and appropriate to implement coordinated countermeasures against those NCCTs that do not take steps to reform their systems appropriately, including the possibility to condition or restrict financial transactions with those jurisdictions"[144].

While these threats have attracted criticisms from the countries targeted and from some academics, the NCCT process has been acknowledged as having gone a long way in encouraging the world-wide adoption of the FATF standards. The expansion of AML/CTF standards throughout the globe through the FATF and the FATF-style regional bodies (FSRBs), policy and strategy buy-in and collaboration from the World Bank and the IMF, the UN, the development of inter-governmental cooperative networks like the Egmont Group of Financial Intelligence Units,

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140 FATF. 2003. *Annual review on non-co-operative countries and territories.* NCCT Reviews. Paris: FATF Secretariat, OECD. p.3.
141 *Ibid.* p. 17.
142 The G7 comprises the US, Japan, UK, France, Germany, Canada and Italy.
143 Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy,* Vol. 12(5), pp. 841-859.p. 852
144 *Ibid.*

and the development of private cooperative networks like the Wolfsburg Group of Financial Institutions, has produced a complex network of global governance in the fight against transnational organised crime. While issues of legitimacy raised by Bosworth-Davis[145] and Mitsilegas[146] suggest some of the potential shortfalls of the FATF regime, there appear to be signs that the FATF processes are slowly becoming more inclusive of other countries through the establishment of FSRBs which cover all the world regions.

Perhaps the critics of the FATF may need to pause and consider whether the strategies of blacklisting NCCTs were entirely reprehensible when they could achieve such enormous policy convergence among nation-states. It is highly questionable whether such convergence could otherwise have been achieved by means of the 'soft' voluntarism approach of UNs' 'hard law'. In any case, an argument may be advanced that what the FATF did was merely to encourage countries to adhere to the UN 'hard law' measures, which many of them had already signed up to and ratified when they acceded to the Vienna Convention. What the FATF, perhaps, did was simply to collect information and to expose those countries that had not put systems in place to support their UN obligations. In other words, the FATF 'soft law' measures could be seen as having complemented UN 'hard law' measures.

Slaughter[147] has argued that 'government networks' herald a new and attractive form of global governance by enhancing the ability of states to work together to address common problems without the centralised bureaucracy of formal international institutions. However, the FATF system may still be accused of being insufficiently democratic and insufficiently expert by not having democratic participation and expertise from all sectors affected by its regulations,

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[145] Bosworth-Davies, R. 2006. Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp.346-364.

[146] Mitsilegas, V. 2003. Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance. In *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. (eds) London:Routledge**.** pp. 195-209.

[147] Slaughter, A. 2003. Global government networks, global information agencies and disaggregated democracies. *An Introduction to law and regulation: texts and material*. B. Morgan and K. Yeung. Cambridge: Cambridge University Press**.** 290-298.

respectively, i.e. developing countries and private sector institutions within its working groups that formulate its standards. In *Chapter 8*, we examine issues of legitimisation in this regards.

An important issue of our research is the extent to which the global anti-money laundering policies take cognisance of the varied socio-economic conditions of different nation-sates. Recall Vaslamis Mitsilegas's message: "FATF standards are not only linked with the formation of economic policy, but have major implications for the receiving countries' legal systems."[148] The global AML/CTF standards seem to expect nation-states to adopt similar policies in rather dissimilar socio-economic conditions without regard for the implications that such policies may have. In some European countries, a growing number of researchers have attested to the lack of effectiveness of the FATF standards in combating crime[149]. They argue that these standards may have increased the cost of doing business and have also become very intrusive on civil liberties[150]. The shortcomings of these standards, having been observed in well-to-do countries like Germany, Singapore and Italy beckon scholars to examine their practical weaknesses and the costs that implementation imposes. Both problems may be amplified amidst socio-economic conditions of developing countries.

It should be clarified that it is not the intention of this research to suggest that the global FATF standards should not be implemented in some countries because they are poor. The aim is instead to look at those developing countries that are implementing them, in this case South Africa, and to query whether any shortcomings in the design and implementation mechanisms could be corrected, minimised or better managed. It is also to examine whether the alleged noble intentions and possible contribution of these standards could be adjusted to enhance the interests of South Africans.

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[148] Mitsilegas, V. 2003. Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance. In *Transnational organised crime: perspectives on global security*. A. Edwards and P. Gill. (eds) London: Routledge**.** pp. 195-209, p.209.

[149] Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*. Vol. 10(1), pp.91-105.

[150] *Ibid.*

Purpose of the Study

The goals and objectives of this study, therefore, include an examination of: (a) the emergence, (b) justifications and (c) implementation of the FATF regulatory standards against money laundering in South Africa. The objectives deriving from these goals are as follows:

1. An historical examination of the emergence and justification of the anti-money laundering business regulations of the FATF both at a global and national level (South Africa).
2. A critical examination of South Africa's experiences with the implementation of anti-money laundering regulations.
3. An analysis of whether or not developing countries can fully comply with the global AML regime as developed by the FATF without compromising some of their developmental goals and needs.

Research questions

The research questions arising from the above objectives are as follows;

- Objective 1 is addressed by the questions: (a) Why and how did the global regulatory regime against money laundering emerge? (b) How and why was this regime introduced and legitimated in South Africa?
- Objective 2 is addressed by the following questions; (a) Have the regulations against money laundering been implemented, has compliance been sought and enforced in South Africa and if so, how? (b) In the implementation of these regulations what have been the successes, challenges and failures?
- Objective 3 is addressed by the following question; (a) What have been the unintended consequences of these global AML regulations in South Africa? (b) Should South Africa fully implement these and, if so, how can the country avoid their unintended consequences?

Hypotheses

This is the study of regulation at both global and domestic levels. As a result of this, the theories of regulation were used to develop two competing hypotheses during the preliminary phases of this project in order to guide data collection and analysis[151]. The following two main competing hypotheses were developed using the 'public interest' and the 'private interest' theories of regulation[152]. The main public interest hypothesis reads as follows:

> *The global FATF standards emerged to serve public interest goals of detecting and combating crime and to protect the interconnected global financial system from being misused for illicit purposes. Where these standards are implemented, they may be expected, if successful, to start to show positive signs of detecting crime and thus contribute in protecting and preserving the integrity of the global financial system.*

A competing hypothesis which is based on the private interest theories of regulation is as follows:

> *The global FATF standards did not emerge primarily to detect and combat crime, but rather to serve some narrow interest including and especially those of Western countries that instigated the formation of the FATF and its standards. The implementation of these standards may or may not result in an effective and efficient regime that positively contributes to the achievement of the alleged public interest goals of detecting or combating crime and protecting the stability of the global financial system as that is not their primary purpose.*

[151] See Chapter 3.
[152] See Chapter 3 for a discussion on these theories of regulation.

Delimitations and limitations of the study

This is not a study of organised crime, either globally or in South Africa, but rather of responses to it. It is a study of the means to control it, or rather its regulation, through the business regulatory strategies of the FATF. We do not claim to exhaustively interrogate the global AML policies for they are broad. We focus specifically instead on the emergence and incorporation of these business regulation strategies and the experiences with their implementation in South Africa. Although they emerged as soft-law standards, they have found their way into both international hard law conventions and protocols and into the legal, regulatory and institutional framework of South Africa.

Chapter 2

FATF regulations as crime prevention and risk regulation strategies

Introduction

The focus on money laundering and the financing of terrorism in many countries and at a global level has expanded on the traditional methods of combating crime. Over the past two decades, new methods focusing on 'regulation' have evolved, regulating not criminals directly, but rather seeking to shape their behaviour through 'hardening their targets' and 'controlling the facilitators' of crime. During this period, private institutions and professionals have begun to be co-opted in order to enlist their assistance in controlling crime when conducting business with their customers. These parties include banks, insurance companies, money transmitters, brokers, lawyers, accountants, casinos, estate agents and dealers in high value goods such as vehicles, jewellers and fine art dealers.

This chapter focuses on two main issues; one, the emergence and two, the contents of this important type of regulation on businesses (and professionals). The introductory chapter has already given some background regarding this regime and its strategies of fighting crime by restricting resource flows both by deterring the 'laundering' of dirty money into clean and legitimate resources and by criminalising this and by seizing crime proceeds and instrumentalities. These business regulatory systems also seek assistance in uncovering crime, especially serious organised crime and terrorism, through the traces of money flows. This chapter aims critically to examine the substantive contents, the ideological influences and values behind such content or form of regulation. Secondly, we aim critically to examine the reasons advanced for the emergence of this type of regulation. We do this by probing the reasons advanced by particularly the FATF, at a global level. In doing these two tasks, this chapter is divided into two sections. In the first section, and in line with probing the substantive contents of the global FATF standards against money laundering, we argue that these standards are influenced by two basic techniques. These are; one, the 'situational crime prevention' technique and; two, the risk management approach to combating crime. Both these techniques are interlinked and have both advantages and shortfalls in the combating of crime, especially for money laundering and for the financing of terrorism.

We argue, therefore, that grounding the design of the global FATF standards on these techniques may be ill-advised and may compromise the goals and the ends sought by the regime. This means that the regime, theoretically, may struggle to achieve its alleged goals. It may instead exacerbate the problems it seeks to curtail. However, before indulging in this analysis, we start first by describing at a conceptual level the regime itself -- the rules and institutions it has set in place. Then, we move on to probe the contents of these FATF standards, particularly their goals and rationales.

Anti-money laundering: contextualizing the regulations

As mentioned in the first chapter, the business regulatory measures of the FATF are just one aspect of a broader regime developed at a global level with the aim of fighting organized crime at national and transnational levels. The global appearance of these regulations is generally traced from the United Nations' Vienna Convention against Trade in Illicit Drugs and Psychotropic Substances of 1988[153], hereinafter called the Vienna Convention. The Vienna Convention, as discussed in the previous chapter, advocated the criminalization of proceeds of drug-related crimes, their confiscation and forfeiture. This technique of attacking the proceeds of crime was followed by the establishment of the FATF by the Group of 7 countries in 1989[154]. In this chapter we argue that this technique of dealing with crime through seizing and forfeiting its proceeds is

[153] See *United Nation's Vienna Convention on Illicit Drugs and Psychotropic Substances* of 1988.
[154] See Chapter 5 and 8 for more on this history.

premised on ‘situational crime prevention’ and the ‘risk management’ techniques of crime combating.

The global AML standards are very broad and cut across various scholarly disciplines. This includes aspects premised on criminal law, civil law, international cooperation (international law and international relations), governance, business regulation and risk management. The main, but not exclusive, focus of this work is on the business regulatory aspects. The regulatory aspects of these standards, as shall be shown below, require countries to regulate private businesses to assist in the combating or detection of crime. We have already briefly discussed the five key components of the global regime against money laundering and terrorist financing as promoted by the FATF in Chapter 1.The first main component of the global AML policies is based on criminal law and requires countries to criminalise the laundering of proceeds of crime.

The second component relates to asset forfeiture of ‘proceeds’ and ‘instrumentalities’ of crime[155]. They complement the criminal law aspects that criminalise proceeds of crime by prompting for legal mechanisms through which proceeds and instrumentalities of crime should be forfeit. A third component includes a series of requirements for countries to promulgate laws that would facilitate international cooperation in criminal matters, especially those relating to transnational organised crime, terrorism, corruption and money laundering[156]. This takes the form of what is referred to as ‘mutual legal assistance’ and ‘extradition’ treaties[157].

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[155] See Naylor, R. T. 2003. Follow-the-money methods in crime control policy. In *Critical Reflections on Transnational Organised Crime, Money Laundering, and Corruption.* M. E. Beare (ed.). Toronto: University of Toronto Press, p. 256.

[156] See FATF. 2003. *The Forty Reccommendations: incorporating the amendments of 24 October 2004.* FATF Secretariat: Paris. See also Joutsen, M. 2005. International cooperation gainst transnational organised crime: extradition and mutual legal assistance in criminal matters. In *Handbook of Transnational Crime and Justice*. P. Reichel (ed.). London: Sage Publications**.** pp. 255-274

[157] Joutsen, M. 2005. International cooperation gainst transnational organised crime: extradition and mutual legal assistance in criminal matters. In *Handbook of Transnational Crime and Justice*. P. Reichel (ed.). London: Sage Publications**.** pp. 255-274

While the first three components of the global regime emanate from the Vienna Convention of 1988, the last two components were developed by the FATF, borrowing mainly from the US[158]. They involve, fourth, the creation of new criminal justice/intelligence organizations/ regulatory or administrative bodies known as the Financial Intelligence Units (or FIUs) by states[159]. The last component requires, fifth, governments to regulate some private businesses to perform various anti-money laundering and counter-financing of terrorism roles. These include; the reporting of 'suspicious', 'unusual' and 'cross-border' and 'threshold' transactions of customers by regulated businesses to FIUs, the training of staff of regulated businesses to identify and report such transactions, CDD/KYC, record keeping of customer identification, proof of residence and transaction data for extended periods of time and to appoint senior staff as Anti-Money Laundering Reporting/Compliance Officers[160]. We discuss these business regulatory measures in greater detail below.

Before doing so, we begin by examining the two main goals of these regulations and their justification by the FATF. The first goal is the one of combating or controlling crime by means of, we suggest, situational crime prevention techniques of regulating private businesses. The second goal is aimed at combating the misuse of businesses by criminals to preserve prudential soundness. This second leads to a risk management rationale for the regulations.

Combating crime: situational crime prevention theory

Crime prevention measures have from time to time embraced various strategies. They have, among others, included the rehabilitation of convicted offenders and prevention of crime through social programmes aimed at curing the social causes of crime. However other measures aim to

[158] See *Chapter 5* on the discussion of the origins of the business regulatory measures of the global FATF standards.
[159] *Ibid.*
[160] See FATF. 2003. *The Forty Reccommendations: incorporating the amendments of 24 October 2004.* FATF Secretariat, Recommendation 4 to 25, pp.4-10.

deter offending absolutely through heavy sentences or to decriminalise the behaviour completely. Still others seek to prevent crime by reducing the opportunities to commit it by manipulating the situational environment in ways that make offending less possible. Anti-money laundering policies have, we suggest, embraced this last strategy of crime detection and prevention. They highlight the situational settings and seek to prevent crime by manipulating them.

Within criminology, most academic work on situational crime prevention has generally focused on the so-called 'street' or property crimes such as robbery[161], theft/shoplifting[162], vandalism[163] and burglary[164]. Much of the work has focused on architectural design, seeking to design out crime or to make it difficult or more risky to commit crime. Situational crime prevention basically concentrates on two main aspects; (i) reducing the opportunities for offending through making crime more difficult or increasing the chances of an offender being caught and (ii) denying criminals the benefits of committing a crime[165]. This involves reducing opportunities for crime and improving security measures (or what is referred to as 'target hardening' or 'controlling facilitators' of crime) so that criminals find it difficult or more risky to commit crime[166]. Through more stringent security measures, it also assumes that criminals are more likely to get caught when they commit a crime[167].

Situational crime prevention is premised on two main theories: the rational choice theory and the routine activities theory[168]. The routine-activities theory presumes that for a crime to occur there has to be 'a likely offender, a suitable target and the absence of capable guardians'[169]. The

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161 Gill, M. 2000. *Commercial robbery*. London:Blackstone Press.
162 Walsh, D.P. 1978. *Shoplifting: controlling a major crime*. London:Macmillan Press.
163 Clarke, R. V. G. (1978). *Tackling Vandalism*. London:Home Office.
164 Waller, I. & Okihiro, N. 1978. *Burglary: the victim and the public*. Toronto:University of Toronto Press.
165 Clarke, R. (1980). Situational Crime Prevention: Theory and Practice. *British Journal of Criminology*, Vol. 20 (2), pp. 136-147
166 *Ibid.* Welsh, B. C. & Farringdon, D.P. 1999. Value for money? A review of the costs and benefits of situational crime prevention. *British Journal of Criminology.* Vol. 39 (3), pp. 345-366.
167 *Ibid.*
168 Ekblom, P. & Tilley, N. 2000. Going equipped: criminology, situational crime prevention and the resourceful offender. *British Journal of Criminology.* Vol. 40 (2), pp. 376-398
169 *Ibid.* p.377

rational choice theory posits that offenders take reasoned decisions to commit crime based on anticipated gains and costs[170]. These include the risks of being caught, the effort they have to put in to committing the crime, and also the assessment of whether or not the utility of the anticipated reward/benefit is worth the risk they would take to commit that crime[171]. Situational crime prevention, unlike traditional crime prevention approaches which focus on curing the social causes of crime, has been seen as very practical to implement, with 'more prospects of shorter term and measurable success'[172]. However, this may not always be the case, especially applied to money laundering (see discussion below).

It is important to recap the justifications given by particularly the FATF in promoting the imposition of the regulatory regime on private businesses. The first is that by regulating private businesses to perform a plethora of regulatory tasks, as discussed below, this will assist law enforcement agencies in detecting money laundering and its predicate crimes[173]. This has been based on the reasoning and evidence that criminals do indeed use products like bank accounts for criminal ends[174]. For instance, they do transfer money between each other and to various jurisdictions. They also purchase goods and services using money earned from criminal activities. There are input costs to criminal activities and as a result of this, it is plausible that profit-driven criminals do often reinvest their criminal proceeds to committing more crimes in trying to maximise their gains. As a result these business regulatory measures are premised on the view that some vulnerable businesses become 'facilitators' of crime or 'targets' of criminals for money laundering purposes. The regulated businesses, in the context of situational crime prevention, could therefore be viewed in two ways; (i) as 'targets' and/or (ii) as 'facilitators' of money laundering, and therefore its predicate crimes.

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170 *Ibid.*
171 *Ibid.*
172 *Ibid.*
173 See FATF. 1990. *Annual Report 1990*, FATF Secretariat, OECD, Paris, and FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris: FATF Secretariat, OECD.
174 *Ibid.*

If regulated businesses are viewed as 'targets', this connotes a view of them as (possible) victims of crime. On the face of it there might seem to be a contradiction. This is because these businesses offer a variety of services to their customers and stand to benefit through the charges and service fees they impose. Instead of becoming victims of crime, the opposite holds as they benefit through transaction fees from such criminal transactions. As a result, regulated businesses could be viewed not as victims, but rather as benefiting 'facilitators' of crime. They may facilitate crime (perhaps unintentionally) by providing convenient services for criminals to launder their crime proceeds or to transact with each other.

In this nexus, regulated businesses become the targets of criminals, not necessarily as victims of crime, but as (unknowing or unsuspecting) facilitators of crime. For the sake of clarity, we give an example of this. Mr. A based in London pays for a consignment of drugs from Mr. B in Colombia, South America. He instructs his bank (Bank A) in London to transfer £10,000 to the bank account (in Bank B) of Mr. B in Colombia. Bank A in London does as instructed and transfers that amount to Bank B. Bank A charges its fees for that transaction, and Mr. B receives his money in Colombia. Bank B in turn charges him for the service. Both these banks would not know that their customers were exchanging drug-money through that transaction. They would not even be interested, as long as they receive their charges or transaction/service fees. However, both Mr. A and Mr. B have easily and conveniently concluded a criminal transaction.

Both these banks have not lost anything, but have instead gained in transaction fees for the use of their services by both these criminal customers. However they have just (unknowingly) facilitated a criminal transaction. We return to this example below to give a picture of what is expected of these banks with the FATF business regulations in place in both these countries. There is another explanation of how businesses may become 'victims' of money laundering activities. This explanation postulates that regulated businesses may be exposed to a variety of 'risks' which arise from their *ex post* association with criminal activities. These 'risks', which make regulated businesses possible victims are not directly linked to the crime prevention role, but to the goal of maintaining the prudential soundness of financial institutions. These ‘risks’ are analysed from the perspective of risk management which is discussed below.

The situational crime prevention technique upon which the FATF business regulatory standards are based, could therefore be viewed as a form of ‘target hardening’ or as a means of ‘controlling facilitators’ of crime[175]. Both ‘target hardening’ and ‘controlling facilitators’ are two of the many techniques advocated by the proponents of situational crime prevention. These techniques, it is believed, serve to reduce opportunities for crime to occur[176]. It is important at this point to summarize the main anti-money laundering business regulatory requirements as proposed by the FATF and implemented in many countries. These requirements were discussed in the previous chapter and in Chapter 4 and as a result they are but briefly outlined here. The primary requirements[177] are that the affected businesses must put in place:

- Customer Due Diligence (CDD) or Know Your Customers (KYC) measures and procedures of identifying and verifying residential addresses of customers;
- internal systems, procedures, policies and guidelines to monitor for signs of money laundering and appoint responsible employees to execute duties in relation to such internal systems;
- training programmes for employees to implement and comply with AML/CTF requirements;
- Record keeping mechanisms of ‘know your customer’ information and customer transactions for specified periods of time, normally five years in many jurisdictions; and
- Transaction-reporting mechanisms (i.e. report to the FIUs ‘suspicious’ or ‘unusual’, and cross-border and local transactions that exceed threshold amounts as set out in

[175] Clarke, R. V. 1995. Situational crime prevention. In *Crime and Justice (Vol. 19) Building a safer society: strategic approaches to crime prevention.*pp. 19-150. p.110
[176] *Ibid.*
[177] FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris: FATF Secretariat, OECD.

national regulations of many countries)

There are a number of unclear elements and challenges arising from these regulatory requirements in many jurisdictions. However these are not discussed here, but in more detail in subsequent chapters. But to give an example of the challenging elements of these regulations, we return to the drug consignment example given above. With these regulatory requirements in place, Bank A in London would be expected to examine whether Mr. A's payment to Mr. B in Colombia represent any criminal activity. This may include some searching and questioning of why Mr. A transferred money to Mr. B in Colombia. Has he performed transactions like that before? Could there be any legitimate reason for such a payment? After evaluating all possible questions about this transaction, the regulations would expect that Bank A makes a finding on whether this transaction is suspicious or unusual or not. If it is suspicious or unusual to Bank A's subjective judgment, then a report must be made to the designated Financial Intelligence Unit.

In Colombia, Bank B would be expected to perform the same exercise. All these activities of determining the legitimacy of transactions of customers mean that regulated businesses now have to spend more resources than they would have done in the absence of the AML regulations. Problematic with the recommendations is that there appears to be no jurisdiction that has managed to give an ultimate definition of what is meant by the term 'suspicious' transaction[178]. This function calls for subjective judgments which may not be uniform between regulated businesses, even those providing similar services such as banks. Some transactions may appear suspicious to one, while they look quite normal to others[179].

There are a number of other challenging elements in the AML business regulations. For instance, there are difficulties about the KYC/CDD requirements of client identification and address verification. Some countries such as the UK, for instance, do not have a national identity

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[178] Bosworth-Davies, R. 2007. Money laundering: the implications of the global money laundering laws-chapter five. *Journal of Money Laundering Control.* Vol. 10 (2), pp. 189-208.

[179] See more discussion on this in Chapter 7.

card/document. There are difficulties on what to use in establishing a client's identity accurately as not everyone owns a passport or driving license which are widely accepted as forms of identity[180]. As mentioned above, one of the main goals of all these business regulatory measures is crime detection or prevention. It is anticipated that regulatory compliance by regulated businesses would assist law enforcement in detecting and preventing crime. This will occur as regulated businesses file reports of suspicious and threshold transactions to their designated FIUs[181]. There is also an expectation that law enforcement agencies would investigate such reports and in the process uncover money laundering and its underlying offences[182]. The expected effect of this on the behaviour of rational and calculating criminals is that they would desist from using regulated businesses to launder money as they are more likely to get caught.

The business regulations complement other requirements of the global FATF regime such as asset seizure and forfeiture, which are aimed at removing the benefits of offending. The latter is linked to the reasoning that criminals should not benefit from the proceeds of their criminal activities[183]. The regulations assist in this process by generating information on transactions and providing such to the FIUs. Where assets are successfully seized and are forfeited to the state, this tool could be seen, in the language of situational crime prevention, to have some 'diffusion of benefits'[184]. This is because it not only removes benefits but also prevents criminals from reinvesting their proceeds in further criminal activities. This is much like hitting two birds with one stone. The intent is to reduce the rates of other predicate acquisitive crimes that necessitate the laundering of their proceeds[185].

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[180] De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime,* Vol. 13(1), pp.6-50..

[181] See Chapter 7.

[182] *Ibid.*

[183] NCIS. 2003. *United Kingdom Threat Assessment of Serious and Organised Crime 2003.* Crime Threat Assessment. London: National Criminal Intelligence Service. p.53

[184] See Ekblom, P. & Tilley, N. 2000. Going equipped: criminology, situational crime prevention and the resourceful offender. *British Journal of Criminology.* Vol. 40 (2), pp. 376-398.

[185] NCIS. 2003. *United Kingdom Threat Assessment of Serious and Organised Crime 2003.* Crime Threat Assessment. London:National Criminal Intelligence Service. p.53.

The main criticism against situational crime prevention has been on the issue of crime 'displacement' or 'deflection'. It has been argued that situational crime prevention does not necessarily prevent crime but simply deflects or displaces it in any of the six ways[186], as follows:

> "…Temporal- where offenders commit crimes at different times of the day; tactical- where offenders adopt a different modus operandi; target- where offenders select a different type of target; type of crime—where offenders choose to commit a new type of crime; spatial—where offenders target new locations; and perpetrator- where apprehended offenders are replaced by new ones."[187]

The business regulatory techniques of situational crime prevention may suffer from the same criticisms. Geiger and Weunsch's work[188], although not mentioning situational crime prevention, provides what we may effectively use to critique the business regulatory techniques of situational crime prevention. In their work, *The fight against money laundering: an economic analysis of a cost-benefit paradoxon*[189], they examined a survey conducted on Banks in Switzerland, Germany and Singapore. They claim that during the two decades through which AML business regulations were implemented in these countries, organised crime has continued to flourish because criminals have alternative unregulated informal channels through which to launder money[190]. They also claim that the anti-money laundering regulations do not tackle the predicate offences (such as drugs) and the demand side that necessitates these predicate offences and subsequent money laundering[191]. They further claim that instead, the business regulations have imposed an unrealistic regulatory cost burden on society. These costs include what they term

[186] Bowers, K. J. & Johnson, S.D. 2003. Measuring the geographical displacement of crime. *Journal of Quantitative Criminology*. Vol. 19(3), pp. 275-301.
[187] *Ibid.* p. 276.
[188] Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control.* Vol. 10(1), pp. 91-105.
[189] *Ibid.*
[190] *Ibid.* p.57
[191] *Ibid.*

‘direct costs’ and ‘collateral damages’. They argue that these costs carry some undesired side effects for both the economy and society[192].

By direct costs they refer to both the production and transaction costs of the regulatory regime which they argue have a severe impact on the economy. This is because the AML regulations push up transaction and production costs for the use of regulated businesses. They argue that regulated businesses pass down to consumers the costs of compliance in the form of increased fees and charges. By collateral damage, they refer to indirect costs to society, such as issues of loss of civil liberties and what they consider as some flawed uses of the AML business regulations[193]. They further argue that these business regulatory measures may even militate against the fight against organised crime as criminals build and cement sophisticated underground laundering techniques through such alternative informal remittance systems such as *hawala* or *hundi* (the Asian informal banking networks)[194]. According to these authors, the use of the informal systems may competitively challenge the formal sector of the economy[195]. They point out that, even in developed countries, the size of the informal sector of the economy is estimated at 10 to 30 percent of the GDP[196].

We now highlight four fundamental weaknesses in the situational crime prevention approach of AML business regulations. We argue that these four weaknesses may make the design and implementation of the regulations unsustainable. The first is that a focus on regulating private businesses may deflect crime into the unregulated sectors of the economy, even as it raises costs in the formal regulated sector. The expansion in nature and scope of the AML business regulations has extended their reach over the past twenty years (see below). This expansion seems to attest to

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192 *Ibid.* p.92
193 *Ibid.*p.98. In relation to this point, Geiger & Weunsch argue that one of the goals of anti-money laundering policy is to protect or counter the use of financial systems by criminals, which is flawed, because ‘…society seems to accept that criminals use other parts of its systems jointly with the non-criminals’ like the transport systems, education system, the legal system, the health care system etc.
194 *Ibid.*
195 *Ibid.*
196 *Ibid.*

their situational crime prevention weakness of crime deflection/displacement. While the initial focus of the global AML business regulations was on drug-related offences and only focused on financial institutions such as banks; all that has changed over the years. The predicate offences of money laundering are no longer only drug-related, but a range of other revenue generating crimes such as corruption, fraud, tax evasion and many more[197].

After the 9/11 terrorist bombings in the US, terrorism -- which clearly seems not to be motivated by any financial gain, has also been lumped into the predicate crimes of money laundering. This was because of the popular belief among some that terrorists use the same laundering methods as criminals to transmit funds destined to finance terrorist activities[198]. As a result of this belief, the traditional focus of AML business regulations has been diluted to more politically-motivated crimes such as terrorism and 'weapons proliferation', where financial gain is difficult to discern.

Over and above that, nowadays it is no longer only banks that are regulated to combat money laundering, but also a range of other businesses and professionals such as estate agents, lawyers, dealers in high value goods, casinos, auditors and accountants. Is it possible that the initial regulation of only banks deflected money laundering to these other types of regulated businesses? If that is the case, this may support a criticism of crime displacement/deflection of the AML business regulations. But it could also be that the expansion of these regulations beyond banks has little to do with crime displacement, especially where criminals have always used these other newly regulated businesses even before the initial regulation of banks.

One major question, however, is how far the AML business regulations will possibly be extended in the future to try and deal with the (potential or real) problem of crime displacement and what the cost implications and practicality of such expansion would be. For instance, might

197 See FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris:FATF Secretariat, OECD.
198 *Ibid.*

educational institutions be expected to consider whether tuition fees of their students emanated from criminal proceeds of their parents/sponsors or not? Could health institutions and supermarkets be similarly regulated in the future? There are also debates as to whether attempts should be made to regulate informal banking systems like *hawala* and *hundi.* How this might be done is unclear since not much is known about these underground banking systems and, where there is information, Passas has claimed, it has often been based on a 'false sense of knowledge'[199].

The second point is that the AML regulations focus on businesses, not on criminal behaviour and criminal markets and market demands. This emphasis on regulating businesses seems to assume that such a strategy will indirectly shrink the demand-side for criminal products and services and rehabilitate the criminal behaviours of criminals. However, according to Geiger and Weunsch, there is no evidence that this occurs[200]. Predicate offences and criminal markets seem to thrive despite these business regulatory endeavours. This could be truer when newer instruments such as civil asset forfeiture, which do not depend on criminal convictions in order to seize assets, are more broadly implemented and encouraged. Rational offenders may read this simply as a form of tax, where the state is either not or less concerned with proving criminality and sending criminals to prison, but with seizing some share of their income. More generally, civil forfeiture raises criticisms that it may violate civil liberties[201]. James Sheptycki has described the forfeiture laws, in general, as extortionate and as a system of 'resource extraction'[202].

The third point is related to the second. Money laundering is only a secondary offence. By this is meant that it depends on the occurrence of other underlying offences such as drug

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[199] Passas, N. 2003. Hawala and other informal value transfer systems: how to regulate them? *Risk Management: An International Journal*, Vol. 5 (2), pp. 49-56. p.49.

[200] Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control.* Vol. 10(1), pp. 91-105.

[201] See Naylor, R. T. 2003. Follow-the-money methods in crime control policy. In *Critical Reflections on Transnational Organised Crime, Money Laundering, and Corruption.* M. E. Beare (ed.). Toronto: University of Toronto Press. p. 256.

[202] Sheptycki, J. 2003. Global law enforcement as a protection racket: some sceptical notes on transnational organised crime as an object of global governance. In *Transnational organised crime: perspectives on global security.* London:A. Edwards & P. Gill (eds.). Routledge**.** pp.42-58. p. 48

trafficking, fraud and many others to generate the moneys that become the proceeds of crime. Without the occurrence of these underlying offences there will be no need for laundering money. Therefore, simply focusing on money laundering does not necessarily tackle the underlying offending behaviour. For instance, when law enforcement agencies seize proceeds related to drug money laundering, they have not necessarily seized the drugs themselves, but the proceeds. These drugs may continue to be consumed somewhere, although criminals would have lost their income as a result of asset forfeiture. The situational crime prevention measures put in place to disrupt the laundering of proceeds leaves undisturbed the demand-side of illegal products (i.e. drugs) and services and the circumstances through which they may be provided. The detection of money laundering, therefore, does not equate to curing addiction for illegal drug users on whose demand drug manufacturers and dealers feed.

The last point that can be made in critiquing the situational crime prevention approach is that there are seemingly disproportionate effects of AML business regulations on civil liberties and the regulatory costs they bring about. While the regulations are intended to impact on criminals and criminal behaviour, they seem disproportionately to impinge on non-criminals as well. For instance, if regulated businesses pass down the costs of regulation to consumers, everyone using their services, whether criminal or not, suffers from these increased costs. While focusing on the facilitators of crime may seem justifiable on a number of grounds, such situational crime prevention regulatory strategies have their weaknesses as discussed above. This suggests that the current design of the global AML business regulations may be flawed and may be inhibited from achieving the crime detection and prevention goals while exerting enormous economic and collateral costs to regulated businesses and, ultimately, to society. We now turn to the second strategy of the AML regulations on businesses-- namely, risk management.

Fostering prudential soundness: the risk management approach

To foster the second goal of the AML business regulations, a risk management strategy was introduced which was normatively aimed at preserving the financial integrity of mainly financial institutions by preventing them from being misused or abused by criminals to launder the proceeds of crime. Above, we discussed how - within the situational crime prevention approach, regulated businesses could be viewed as 'targets' of criminals and an impression could be created that they are potential victims of money laundering or crime. However the fees or service charges they earn from such transactions make their victim status controversial. There is another powerful line of reasoning that reasserts that victim status portrays money laundering as a risk to the integrity of regulated businesses. Recommendations 4 to 25 of FATF standards focus on how businesses should be regulated within countries[203]. They cite as a goal not only the combating of crime, but also the protection from risk to the wellbeing of regulated businesses[204]. The reasoning behind a strategy of risk management has been that money laundering is a serious hazard to the financial system[205]. Thus, while regulated institutions may benefit by levying fees or charges for transactions carried out by criminals, they end up facilitating money laundering activities. As a result they may face various forms of sanction from regulators and the courts where and when charges are brought against them. The Basel Committee on Banking Supervision (BCBS) has argued that the AML business regulations, especially those focusing on KYC/CDD, are "critical in protecting the safety and soundness of banks and the integrity of the banking systems"[206].

In its report on *Customer Due Diligence for Banks*, the BCBS has argued that sound KYC/CDD procedures should be seen "from a wider prudential, not just anti-money laundering,

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[203] FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris: FATF Secretariat, OECD.
[204] *Ibid.* Preface.
[205] Bartlett, B. L. 2002. *The negative effects of Money laundering on economic development: countering money laundering in the Asian and Pacific region*. Regional Technical Assistance Project, International Economics Group, Dewey Ballantine LLP.
[206] BCBS. 2001. *Customer due diligence for banks*. Basel: Basel Committee on Banking Supervision: Bank of International Settlements. p.2

perspective"[207]. Such procedures must be seen, the Basel Committee argues, "as a critical element in the effective management of banking risk"[208]. From this perspective, the AML business regulations are seen as a risk management tool for financial institutions. However, this may extend to other categories of regulated businesses such as lawyers, accountants, brokers and others who may be struck-off their professional rolls of practice if criminally convicted or administratively sanctioned for money laundering related lapses. The BCBS, in the same report, identified four interrelated 'customer and counterparty risks' which it lists as "reputational, operational, legal and concentration risk"[209]. According to the BCBS, these risks 'can result in significant costs to banks' such as bank runs, termination of interbank facilities, claims against the bank, loan losses, and asset confiscation and forfeiture. In this sense, banks become 'victims' of money laundering activity. However, it is important to note that most of the risks mentioned by the Basel Committee are not directly caused by money laundering. Instead they are as a result, directly or indirectly, of regulation. They arise from the failure of regulated businesses to comply with their regulatory obligations.

Reputation risk involves 'the potential that adverse publicity regarding a bank's business practices and [criminal] associations, whether accurate or not, will cause a loss of confidence in the integrity of the institution'[210]. The reasoning here is that if regulated businesses (especially banks) are associated with money laundering activity (and therefore criminals), such associations may harm their credibility or reputation 'since the nature of their business requires maintaining the confidence of depositors, creditors, and the general market place'[211]. Therefore complying with the KYC/CDD procedures would limit their exposure to money laundering and its perceived associated harms to reputation. Operational risks are identified in the Basel Committee report as the 'risks of direct or indirect loss resulting from failed internal processes, people and systems or

207 *Ibid.*
208 *Ibid.*
209 *Ibid* .p.3
210 *Ibid.* p.4
211 *Ibid.*

from external events'[212]. This risk relates to institutional failures or weaknesses in implementing internal anti-money laundering regulatory programmes, therefore exposing banks to money laundering.

Legal risks refer to adverse judgments that the regulators and the courts may impose on regulated businesses. Beyond these costs, there may be added reputational effects. Lastly, the report refers to 'concentration' risk. Concentration risks contain elements of credit and liquidity hazards. On the credit and liquidity side, it entails banks not properly profiling their customers. This means that banks may lend money in excess of what is sound or lend to the same group of customers under hidden webs of linked identities, if they have not properly profiled them. Alternatively, they may unknowingly have larger deposits than they realize, from the same group of customers, which may expose them to liquidity problems should that group of customers decide to withdraw their investments. The risks identified by the Basel Committee's report are highlighted in order to encourage banks to comply with the AML business regulations. In part, but not exclusively, these risks would tend to arise when banks are investigated by regulators, and found to be non-compliant. If this happens, then reputation could be at stake (reputational risk), costs implications could come into play as non-compliant institutions are fined (legal liability risks), and their systems could be exposed as weak (operational risk) and susceptible to concentration risks.

Bartlett has extended this risk thesis in a report compiled for the Asian Development Regional Technical Assistance Project, funded by the World Bank, entitled *Countering Money Laundering in the Asian and Pacific Region: The negative effects of money laundering on economic development*[213]. He basically argues that money laundering activity has got negative consequences on economic development in developing countries. His focus is much more on the role that financial institutions such as banks and capital markets play in economic development[214].

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212 *Ibid.*
213 Bartlett, B. L. 2002. *The negative effects of Money laundering on economic development: countering money laundering in the Asian and Pacific region.* Regional Technical Assistance Project, International Economics Group, Dewey Ballantine LLP, London.
214 *Ibid.* p.10

He argues that financial institutions provide access to capital for borrowers and confidence/certainty for lenders that they stand a reasonable chance of returns on their investments[215]. He argues that in developing countries, financial regulation and supervision is generally less rigorous and therefore there is not enough confidence provided for investors to entrust financial institutions with their investments[216]. According to him, faster growing economies do not only have stronger financial institutions, but also prudentially sound institutions which drive economic growth. Therefore regulated financial institutions, which AML regulations contribute to, would play a major role in economic development in developing countries where capital is normally scarce[217].

This scarcity of capital in developing economies has historically led to large financial institutions' over-reliance on public/government funds, rather than private deposits, which are equally important[218]. Bartlett highlights the central role of sound financial institutions for access to capital for 'private entrepreneurs to emerge, for business to flourish, and for local people and investors from abroad to find the confidence to invest, create wealth, income and jobs'[219]. He also notes how recently the IMF and the World Bank have made compliance with the FATF standards a precondition for grants and loans for many developing countries. According to him, the AML regulations support financial institutions by fostering enhanced financial prudence, promoting good governance and exerting 'positive secondary effects on economic development'[220].

On this point he cites the KYC due diligence measures which may assist financial institutions to mitigate 'concentration risks' through avoiding over-exposure to particular clients. Contrary to arguments by Geiger and Weunsch[221], Bartlett claims that while, in the short term,

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215 *Ibid.*
216 *Ibid.*
217 *Ibid.*
218 *Ibid.*
219 *Ibid.*
220 Ibid.p.11
221 See Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control.* Vol. 10(1), pp. 91-105.

compliance costs may seem cumbersome; these costs should be measured in the context of the long-term goals of the regime. He admits that compliance costs may prove burdensome if there is no uniformity in implementation, compliance and enforcement. This is especially the case where some institutions comply and bear the costs while some do not at all and such non-compliance is neither rectified nor punished.

Another argument made by Bartlett is that money laundering has direct negative effects on economic growth[222]. This is based on his assumption that laundered funds are normally diverted to less productive activity like facilitating corruption and furthering crime. For Bartlett, laundered money may even be 'placed outside financial institutions and end up in sterile investments or investments that do not generate additional productivity for the broader economy'. In this regard he cites investments on real estate, art, jewellery and other high value consumption assets such as boats and luxury vehicles[223]. Although it is difficult to understand how investment in real estate and other luxury goods depresses growth, Bartlett makes an example about sterile investments in real estate. He argues that money launderers can, **'**hypothetically**'**, drive up the prices of real estate, for instance, causing overpayment for these assets and therefore distorting real estate market prices[224].

The last argument that Bartlett makes is that money laundering can increase the risk of macro-economic instability, distort capital and trade flows[225]. On the issue of macro-economic stability, he argues that money laundering flows through a particular region are often triggered by specific episodes of political flux such as an overthrowing of a corrupt dictator. He says such events may lead to unstable financial flows, which, when accompanied by money laundering activity, may contribute to instability of exchange rates, monetary aggregate and general price

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222 Bartlett, B. L. 2002. *The negative effects of Money laundering on economic development: countering money laundering in the Asian and Pacific region*. Regional Technical Assistance Project, International Economics Group, Dewey Ballantine LLP, London.
223 *Ibid*.p.18
224 *Ibid.*
225 *Ibid.*

levels[226]. Further on the point of macro-economic stability, he notes that some money laundering transactions take place in the informal sectors of the economy. As a result such transactions do not appear in official monetary and financial statistics, thus distorting the real picture of these statistics for monetary policymakers in their management of economic variables such as monetary levels, interest rates, inflation and exchanges rates[227].

On the issue of money laundering distorting capital and trade flows, Bartlett mentions the laundering of outbound funds (meant for offshore/another country) which may, where extensive, encourage capital flight and therefore worsen the scarcity of domestic capital for developing economies[228]. It would therefore seem, according to Bartlett's arguments, that the solution for all these problems that money laundering may cause to developing countries is for them to adopt the 'prudential' risk managing AML business regulations. According to Bartlett's analysis, these measures do not only seek to prevent crime and maintain the prudential soundness of the regulated businesses, especially financial institutions, but could be seen as a means of encouraging economic growth and development by assisting in the building of sound financial institutions. However, the risk management approach, as articulated by the BCBS and Bartlett, may be overly optimistic in encouraging financial institutions to comply with the AML regulations.

After all the BCBS is made up of countries (the Group of 7 countries) who formed the FATF. These countries cannot be seen to be communicating different messages to those of the FATF. Bartlett's report was commissioned by the World Bank to encourage compliance with the AML standards in developing countries of Asia. Both the BCBS and Bartlett's reports, in their drive to promote the global FATF standards, tend to overlook a number of additional problems that may beset their design and implementation. We have discussed Geiger and Weunsch work above which raised some criticisms on the administrative and compliance costs of the regime. Other academics have also highlighted these. For instance Alexander *et al*. have argued that the

[226] *Ibid.* p.22.
[227] *Ibid.*
[228] *Ibid.* p.24.

AML regulations dramatically increase ‘the cost of doing business in the financial sector”, especially in developing countries[229]. According to them, these regulations

> …may have the effect of weakening many financial systems by driving liquidity out of the formal market and into the underground economy…This will undermine the crucial role that banks are expected to play in generating economic growth in developing countries…[230]

The credo that injecting money from criminal activity into the economy is dangerous to the economy has therefore not been explained. We can however find an answer from the 1970 US’s Racketeer Influenced and Corrupt Organisation (RICO) Act’s provisions, where these financial regulations originate. RICO says that

> “It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of unlawful debt …. to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise, which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities on the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern of racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities

229 Alexander, K., Dhumale, R. & Eatwell, J. 2006. Global governance of financial systems : the international regulation of systemic risk. New York: Oxford University Press. p.73.
230 *Ibid.*

> of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer."[231]

It can be seen from this provision that the US government was trying to prevent organised crime from engaging in interstate or foreign commerce or from taking a controlling interest in a securities-issuing corporation.

Another point that dislodges Bartlett's argument of economic developmental potential of the global AML standards is raised by Louis De Koker[232]. De Koker argues that the AML regulations, if not implemented carefully, may have adverse effects of economic exclusion and consequent failure of human capital formation, which may depress economic development, especially in developing countries. De Koker's argument is based on the stringent anti-money laundering regulatory requirements of 'know your customer' embedded in the global AML standards of the FATF. According to the 'know your customer' requirements, regulated businesses, particularly financial institutions, are expected to 'identify their customers, obtain information regarding the purpose and intended nature of the business relationship'[233]. In many jurisdictions, institutions such as banks develop 'risk-based' bank account opening procedures which require particular forms of identification. These 'risk-based' systems used by banks also rate customers as high, medium or low risk[234]. The expectation of the 'know your customer' requirements is that regulated businesses should not open accounts or provide their services to customers who do not satisfy their risk-based identification procedures[235]. It follows also that those with more verifiable 'know your customer' documentation would score high points, therefore be low risk customers in terms of client identification and verification requirements.

[231] RICO 18 USCA §1961 et seqq. §1962(a). Thanks to Dr. Frank Madsen for raising and clarifying this point.
[232] See De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime*, Vol. 13(1), pp.6-50.
[233] *Ibid.* p.31.
[234] *Ibid.*
[235] *Ibid.*

Those customers without enough documentation may tend to score low and be placed into the 'high risk' customer categories. De Koker argues that such procedures may unfairly exclude some sectors of society, especially the poor and immigrants, from accessing financial services. To illustrate his point, De Koker cites a study conducted by the Financial Services Consumer Panel in the UK in 2002 which showed that due to the 'know your customer' requirements, a number of people (19% of the sampled applicants) were refused basic bank accounts due to inadequate identity information[236]. One of the traced applicants commented as follows

> They said "Are you working?" I said no, I'm looking for work now. "Any identification?" I said I've got my medical card that's all I've got. They said I need three forms of identification before they can do anything for me. Like a driving licence, passport, birth certificate. Which I haven't got[237].

Clearly, driving licenses are for driving vehicles and passports are normally for travelling. It is highly doubtful that everyone in society drives or plans to travel abroad in order to satisfy the basic bank account opening procedures. Such requirements, according to De Koker, may have implications of 'financial exclusion' or hinder access to financial services. These implications may further mean lack of access to financial products such as insurance, credit and savings facilities. This is especially so on immigrant populations, including economic 'illegals', which make up large percentages of some cosmopolitan cities in many countries. Contrary to what Bartlett argues above, the net effect of the AML business regulations of 'know your customer' requirements could be considerable levels of financial exclusion and perhaps more reliance on underground/alternative remittance systems such as *hawala*, especially for the excluded groups. This could also mean that such transactions elude the official monetary and financial statistics and distort the judgments of monetary policy-makers.

[236] *Ibid.* p.39.
[237] *Ibid.* p.40.

Conclusion

This chapter has looked at two related strategies that are employed by the global AML standards of the FATF to combat/detect crime and to prevent the misuse of legitimate institutions by criminals. Our analysis of these strategies suggests that they, in their present form and design, may contain features that not only militate against the outcomes they seek to achieve but may even exacerbate such problems or create new ones. Two strategies were discussed relating to these goals, and some literature discussed in relation to them. Having looked at the two regulatory strategies employed, we now turn to the regulation literature to theoretically locate the emergence of this regime at a global level. In the next chapter we fuse the regulation theories that were used to develop the competing hypotheses that guided this study with the research methodologies that were employed to collect and analyse data.

Chapter 3

Regulatory theory and research methods

Introduction

In this chapter we discuss the research methodologies that were used to test our hypotheses as outline in the first chapter. These are tested on the strength of evidence gathered from secondary and primary sources. Robert Alford has decried the gap between theory and method in the general conduct of research[238]. He bemoans the fact that much work seems to consist of either 'abstract theoretical speculation, methodological analyses of the properties of various statistics, or rigorous empirical analyses that lack theoretical substance'[239]. Our study is empirical and an effort was made to infuse the research methods with the theoretical substance that Alford finds lacking. In the previous chapter, we examined the AML business regulatory standards. We argued that they were purportedly established to encourage cooperation between countries through persuading nation-states to shape or modify the behaviour of criminals by regulating private businesses within their jurisdictions. This complex multi-level regulation, on the one hand, has affected states which are at different levels of development (developed and developing countries). On the other hand, various types of businesses have been regulated within states to observe the newly enacted domestic codes which emanate from these global standards. These regulated businesses have ranged from financial to non-financial institutions. We have and continue to use the term of 'regulated businesses' throughout this study to refer also to regulated professionals such as lawyers, auditors and brokers.

The alleged normative goals and rationales of all this regulatory intervention has been to detect and combat crime in technologically advanced environments and, in a globalizing world, to

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[238] Alford, R. R.1998. *The craft of inquiry: theories, methods, evidence.* New York: Oxford University Press. p.11.
[239] *Ibid.*

protect from misuse for criminal ends, the legitimate and interconnected financial and non-financial systems. This is being done through situational crime prevention and risk management techniques that we discussed in Chapter 2. The AML business regulatory measures are therefore behavioural modification technologies of governance whose seeming end-goals are to mitigate against the risk of criminal conduct, albeit indirectly, through leveraging the somewhat traditional law-enforcement duties of detecting and combating crime on everyone that can possibly be reached in society. In this research we use the economic and political theories of regulation to interpret and explain the origins and emergence of this global regulatory regime of the FATF and to probe more critically into its founding goals and rationales.

Regulatory scholarship has in the past few decades gained prominence in such disciplines as law, politics, economics and the broader social sciences. Scholars in this multi-disciplinary field have been concerned with a variety of issues such as the privatisation of public services, competition, economic policy formulation and implementation, democracy, legitimacy and accountability of non-elected independent regulatory bodies in conditions of delegated mandates. They have, among other things, sought to study '*why* regulation emerges, *which actors* contribute to that emergence and the *typical patterns of interaction* between regulatory actors'[240].

Regulation theories provide us with some fascinating competing hypotheses which have enabled us to seek alternative interpretations or explanations[241] and they provide evidence of the publicly interested goals of the FATF regime. The private interest hypothesis leads us to tread a less travelled path in this area. It prods us critically to search for and examine evidence to the contrary and to continuously search for hidden interests behind the emergence of the regime. These theories lead us to question the somewhat orthodox and seemingly publicly interested goals and rationales for the emergence of the regime and its incorporation in the developing world and

[240] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press. , p.7
[241] We acknowledge the work of Rowan Bosworth-Davis in seeking alternative explanations to the emergence of the global FATF regime in Bosworth-Davies, R. 2006. Money laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control, 9 (4),* pp.346-364

in South Africa, in particular. They further compel us to question the costs and benefits of the regime, especially evidence and a growing body of work which suggests that the regime is not achieving its alleged goals, not only in the developing world, but also in the originating countries[242]. Further, as we analyse the manner in which the regime came about and how it was disseminated throughout the world, we begin to appreciate the dynamics and typical patterns of interaction among various actors in its rise and to question why and how other countries played and continue to play a leading role and others, mainly developing countries, continue to follow. This is especially so when evidence suggests that they were deliberately excluded in shaping and designing the regime while, at the same time, they were being coerced into adopting and complying with it.

It seems that criminological scholarship has paid little attention to the AML initiatives through the theoretical lens of regulatory scholarship. Nor have scholars of regulation paid enough, if any, attention to or examined how regulation theories could apply to the global AML regime. While the main AML standards were largely influenced by criminal law, through the criminalisation of proceeds of crime, the AML business regulations represent a significant shift in the fight against crime. The obligations they place on regulated businesses are not traditional criminal law instruments, but socio-economic regulatory 'technologies' of governance. They interfere with the political and market economy by dictating the manner in which regulated businesses conduct their day to day affairs with their customers/clients, with great and yet unquantified cost implications. Businesses affected by the AML regulations are already subject to various forms of socio-economic and/or professional regulation. AML regulations, may we suggest, expand and transform the traditional roles of law enforcement such as criminal investigations, surveillance and crime prevention and extend them to the boardrooms and service counters of regulated businesses. They do this by assigning to business the traditional law

[242] See, for instance, Geiger, H. & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*, vol. 10(1), pp.91-105, and our discussion regarding the failures of the regime to help in detecting crime through 'suspicious transaction reporting' in Chapter 7

enforcement roles of detecting and preventing crime[243]. Could regulation theory help us to interpret and explain this transformative scheme in law enforcement roles? In venturing into this exercise of merging regulation theory with our research methods, we first look at what contemporary scholarly literature understands 'regulation' to mean. We then look at the various theories of regulation which Morgan and Yeung[244] have conveniently classified into the public interest theories and private interest theories.

What is Regulation?

Regulation, as a public policy tool, dates back centuries in many countries in the world[245]. As observed by John Braithwaite and Peter Drahos,[246]

> States have always been objects of regulation, regulators and regulatees. States were regulated by the Fuggers in the sixteenth century, the British East India Company in the eighteenth century, the Rothschilds until the 1930s, and today by business organisations like the Big Five accounting firms, IATA, the *Societe Generale de Surveillance*…international organisations like the IMF and World Bank…

However, regulation has only gained currency in academia, as a form of policy making, governance or social control in the past couple of decades. This was due to the regulatory reforms that were tied to the state-market changes associated with privatisation, contracting-out and delegation of powers of government to non-elected bodies for purposes of supplying public

[243] See Levi, M. 1991. Regulating money laundering: the death of bank secrecy in the UK. *British Journal of Criminology*. Vol. 31(2), pp. 109-125

[244] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York Cambridge University Press.:.

[245] Majone, G. 1994. The rise of regulatory state in Europe. In *A reader on regulation: Oxford readings in socio-legal studies.* R. Baldwin, C. Scott, & C. Hood (eds.). Oxford University Press: Oxford, pp. 77-101. Braithewaite, J. & Drahos, P. 2000. *Global business regulation*. Cambridge: Cambridge University Press.

[246] Braithewaite, J. & Drahos, P. 2000. *Global business regulation*. Cambridge: Cambridge University Press. p.27

services such as electricity, water and transport[247]. These regulatory reforms, which became popular under the Ronald Reagan's administration in the US and Margaret Thatcher's Britain, heralded a "movement away from state ownership and reliance on private markets to supply goods and services", including those traditionally supplied by the state[248]. Some have interpreted these shifts to imply the retreat of the power of the state[249] or "hollowing out"[250], referring to the weakening of state authority and the increasing power and dominance of private authority in public affairs.

These shifts have indeed led to the reconfiguration of the role of the state in the economy, as many have observed, from that of being a provider of services or what is popularly known as a 'welfare state' or "provider state" to the role of regulating, through a variety of ways, the supply of such services and hence the designation of a 'regulatory state'[251] or, as some have said, a 'night watchman state'[252]. Although the market plays a major role in supplying goods and services, it is widely agreed, at least in democratic societies, that the state still owes its citizens access to such services. In order to ensure access, the role of the state has shifted to one of regulating the provision of these services. According to Paul Cook *et al*, (2004) state regulation extends to many areas including employment terms, competition, health and safety, food safety, environmental regulation and other specific industry regulatory measures[253]. However, it is important to decipher what regulation has been understood to mean in the academic circles. As many scholars have noted,

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[247] Minogue, M. 2004. Public management and regulatory governance:problems of policy transfer to developing countries. in *Leading issues in competition, regulation and development.* C. Kirkpatrick, Paul Cook, Martin Minogue, David Parker (eds). Cheltenham, Northampton: Edward Edgar:.
[248] *Ibid.* p.3
[249] Strange, S. 1996. *The retreat of the state: the diffusion of power in the world economy.* Cambridge: Cambridge University Press.
[250] Vogel, M.E. 2008. Situating Legislative Drafting. *European Journal of Law Reform*, Vol. 10 (2), pp. 275-293.
[251] Minogue, M. & Cariño, L. 2006. Introduction: regulatory governance in developing countries. In *Regulatory governance in developing countries,* Martin Minogue & Ledivina Cariño (eds). CRC Series on Competition, Regulation and Development. Cheltenham, Northampton: Edward Edgar., pp.3-16, p.3.
[252] Phillips, N. 2006. States and Modes of Regulation in the Global Political Economy. *Regulatory governance in developing countries,* Martin Minogue & Ledivina Cariño (eds). CRC Series on Competition, Regulation and Development. Cheltenham, Northampton: Edward Edgar., pp.17-36, p.28.
[253] Cook, P. 2004. Competition, regulation and regulatory governance: an overview. In *Leading issues in competition, regulation and development.* C. Kirkpatrick, Paul Cook, Martin Minogue, David Parker (eds). Cheltenham, Northampton:.Edward Edgar. p.8.

there is a lack of clarity and precision as to what regulation means[254]. Since there are varying conceptual approaches to the meaning of regulation, this paper will not attempt to reinvent the wheel, but scans the contemporary academic literature and brings to the fore some of the current definitions of the concept of 'regulation'. We suggest a functional definition for the purposes of this analysis, borrowing from the existent ones.

According to Morgan and Yeung, narrower definitions of regulation "tend to centre on deliberate attempts by the state to influence socially valuable behaviour which may have adverse side-effects by establishing, monitoring and enforcing legal rules"[255]. According to such narrower definitions, regulation refers to "the promulgation of an authoritative set of rules, accompanied by some mechanism, typically a public agency, for monitoring and promoting compliance with these rules"[256]. This narrower definition is classified as a legislative approach to regulation. Martin Minogue describes this approach as espousing a "traditional view of government as a command and control regime operating in the public interest"[257].

Another narrow approach in defining regulation is biased towards the economic aspect with regulation being defined as 'all efforts of state agencies to steer the economy"[258]. This second approach views regulation as a means of creating 'conditions for efficient markets'[259]. Many scholars have incorporated both of the legal/legislative and economic approaches in defining regulation. They view regulation, therefore, as 'both a form of public policy and a means of

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[254] Morgan, B. and K. Yeung., p.3. Baldwin, R., C. Scott, et al. 1998. Introduction. In *A reader on regulation: Oxford readings in socio-legal studies.* R. Baldwin, C. Scott, & C. Hood (eds). Oxford: Oxford University Press**.** p.2.

[255] Morgan, B. and K. Yeung, p.3.

[256] Baldwin, R., C. Scott, et al. 1998. Introduction. In *A reader on regulation: Oxford readings in socio-legal studies.* R. Baldwin, C. Scott, & C. Hood (eds.). Oxford: Oxford University Press**.**, p.3.

[257] Minogue, M. 2004. Public management and regulatory governance:problems of policy transfer to developing countries. in *Leading issues in competition, regulation and development.* C. Kirkpatrick, Paul Cook, Martin Minogue, David Parker (eds). Cheltenham, Northampton: Edward Edgar.. p.62.

[258] Baldwin, R., C. Scott, et al. 1998. Introduction. In *A reader on regulation: Oxford readings in socio-legal studies.* R. Baldwin, C. Scott, & C. Hood (eds). Oxford: Oxford University Press**.**.

[259] Minogue, M. 2004. Public management and regulatory governance:problems of policy transfer to developing countries. in *Leading issues in competition, regulation and development.* C. Kirkpatrick, Paul Cook, Martin Minogue, David Parker (eds). Cheltenham, Northampton: Edward Edgar., p.62.

constituting markets'[260]. However some scholars such as Julia Black view the combination of both these legal and economic conceptual approaches still as too narrow.

Morgan and Yeung highlight three assumptions which make the legislative approach narrow[261]. These assumptions are that: 1) the state is almost the only source of articulating the collective goals of the community; 2) the state has a final authority; 3) 'the centrality of rules as 'command' is the primary mode of shaping behaviour'. They note that the primary assumptions have been correspondingly challenged in that there is: 1) an increasing role played by non-state institutions like non-governmental organizations and commercial enterprises, among others, in shaping regulation; 2) an emergence of multiple levels and sites of governance that operate concurrently or in overlapping ways and that therefore challenges the assumption that the state has the final authority; 3) an increasing observation of the limitations to the effectiveness of legal rules and an increasing recognition for alternative techniques of policy formulation and implementation[262].

On the other hand, the economic approach to regulation is critiqued for failing to recognise that regulation is also used for a variety of motives other than correcting market failure[263]. For instance, since 'regulation redistributes resources and rents, politicians often use it to secure political gains rather than correct market failures'[264]. As a result of limitations of both these legal and economic approaches, contemporary regulatory scholarship has increasingly adopted a broader approach which entails the understanding of regulation as "rules enforcement and monitoring", or "any form of direct state intervention in the economy" or "all mechanisms of social

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260 *Ibid.*
261 Morgan, B. and K. Yeung, *supra*, p.4
262 *Ibid.*
263 Minogue, M. 2004. Public management and regulatory governance:problems of policy transfer to developing countries. in *Leading issues in competition, regulation and development.* C. Kirkpatrick, Paul Cook, Martin Minogue, David Parker (eds). Cheltenham, Northampton: Edward Edgar:, p.62.
264 *Ibid.*

control of behaviour"[265]. In this line is a definition of 'decentred regulation' referred to by Julia Black as the 'cybernetic' approach which defines regulations as:

> "…the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes, which may involve mechanisms of standard-setting, information-gathering and behaviour-modification"[266].

Or rather, in a recent re-formulation by Julia Black, regulation means

> "…sustained and focused attempts to change the behaviour of others in order to address a collective problem or attain an identified end or ends, usually through a combination of rules or norms and some means for their implementation and enforcement, which can be legal or non-legal"[267].

While the former economic and legal approaches place emphasis on the state and formal rules, the 'decentred' or 'polycentric' regulation approaches place an emphasis on the multitude of actors who play regulatory roles[268]. They also draw attention to the multi-level platforms through which regulation occurs; the sub-national, national or transnational, highlighting 'the nature of state-society and intra-state and intra-society relationships'[269]. Lastly, they appreciate regulatory strategies as 'hybrid' or 'combining governmental and non-governmental actors', 'multifaceted' or 'using a number of different strategies simultaneously or sequentially' and 'indirect'[270]. Morgan and Yeung have emphasized that the broader 'cybernetic'/ 'decentred'/ 'polycentric' approach to regulation does not seek to dislodge the state and the law[271]. Instead it

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[265] *Ibid.* p. 64.
[266] *Ibid.* p. 65.
[267] Black, J. 2008. Contesting and constructing legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance.* Vol 2, p. 137-168.
[268] *Ibid.* p.139.
[269] *Ibid.*
[270] *Ibid.*
[271] Morgan, B. and K. Yeung (2007). *An introduction to law and regulation: texts and materials.* New York: Cambridge University Press.p.4.

appreciates the role of the state and the law in shaping people's behaviour while also 'enlightening the understanding of regulation and its contemporary realities on the relationship between the state and the range of other actors, institutions and techniques'[272].

In the sense of this broader approach, its expanse could make the concept of regulation rather too porous. However, this broader definition seems to sit comfortably with the nature and scope of the AML business regulations that we study here. These regulations are a result of both 'state' and 'non-state' actors, a product of both formal (hard law) and informal (soft law) mechanisms of control, and originate separately from the nation-state, although the expectations are that states implement and enforce them. It is also required within nation-states that private regulated businesses and professions will implement and comply with the regulations. To distinguish between 'state' and 'non-state' actors we borrow from Julia Black[273]. 'State' actors refer broadly to those organs of government/state with a legal mandate to regulate[274]. 'Non-state' refers broadly to those inter-governmental regulatory bodies or standard-setters (such as the FATF and its range of networks of FATF style regional bodies) with no legal mandate in the form of national and international formal or legally binding conventions and treaties[275].

Theories of Regulation and Hypotheses Generation

We have mentioned before that in this work we have adopted the convenient categorization of regulation theory into the three broad categories of public interest theories, the private interest theories and the institutionalist theories[276]. Our focus is on the competing public and private interest theories. Theories of regulation are a 'set of propositions or hypotheses about *why*

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[272] *Ibid.*
[273] Black, J. 2008. Contesting and constructing legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance.* Vol 2, p. 137-168.
[274] *Ibid.*
[275] *Ibid.*
[276] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press.

regulation emerges, *which actors* contribute to that emergence and the *typical patterns of interaction* between the regulatory actors'[277]. These theories cut across various disciplines such as law, sociology, economics and politics. All these theories have a common concern. This is to uncover the processes that lead to the adoption of particular regulatory regimes[278].

Theories of regulation are a central vehicle to the purpose of this research as they help us examine why the global FATF standards emerged and the manner in which they did. This goal speaks directly to our first research question and the hypotheses linked to this question as outlined in Chapter 1. To reiterate, our first research question asks why and how the global anti-money laundering regime of the FATF emerged and why and how it was disseminated and incorporated in developing countries; particularly South Africa . The purposes of this is to examine the key explanations advanced in order to account for the emergence of this type of regulation in countries (global regulation) and in private businesses (business regulation) within national jurisdictions. In Chapter 2 we identified two key main goals for the emergence of the global AML standards. These key goals are to combat (transnational) organized crime and to prevent legitimate businesses from being used to perpetuate crime. Using regulation theories, we seek to further enlighten our understanding and interpretation of these goals/objectives, critically probing beyond the publicly articulated or official explanations and justifications.

We also use the available literature to highlight some competing explanations for the emergence of this regime globally and nationally, particularly within developing countries - as there are other explanations to the emergence of the global FATF standards. The AML regulations at the national level, as discussed above, regulate private businesses to perform a number of regulatory functions. At a global level, they focus on regulating nation-states —in other words, countries as objects/subjects of regulation. Below, we turn to the exploration of regulation theories, starting with the public interest and then the private interest theories. Using the research questions

[277] *Ibid.*
[278] *Ibid.*

and hypotheses outlined in Chapter 1, we test them with evidence presented in Chapters 5, 6, and 7 of this work.

Public interest theories

The public interest theories "attribute to legislators and others responsible for the design and implementation of regulation a desire to pursue collective goals with the aim of promoting the general welfare of the community"[279]. The public interest theories can be subdivided into two main streams; 1) those that articulate regulatory goals in terms of economic efficiency and; 2) those that include political goals other than the economic ones[280]. The economic approaches of public interest theories hold that the market 'works well under normal circumstances and should be interfered with only when it does not function properly'[281]. The 'regulation of economic activity is justified only when the market is incapable of producing social optimum'[282]. This refers to when the unregulated market fails to allocate its resources and services efficiently as expected of it by society. Regulatory intervention is therefore justified, in the 'public interest', to correct the failure of markets to maximise social welfare. Anthony Ogus has listed a number of economic circumstances which may lead to market failure. These are as follows; (i) existence of monopolies and natural monopolies, (ii) public goods (iii) other externalities, (iv) information deficits and bounded rationality, (v) co-ordination problems, and (vi) exceptional market conditions and macro-economic considerations[283].

We do not go into details with regard to all these reasons given by Ogus and others, but shall explain those that are considered to be relevant to this analysis. In this regard we may point

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[279] *Ibid.* p.17-18.
[280] *Ibid.*
[281] Majone, G. 1994. The rise of regulatory state in Europe. In *A reader on regulation: Oxford readings in socio-legal studies.* R. Baldwin, C. Scott, & C. Hood (eds.). Oxford: Oxford University Press**.** pp. 77-101.
[282] *Ibid.*
[283] See Ogus, A.I. 2004. *Regulation: legal form and economic theory.* Oxford: Hart.. p.26-46 for discussion.

out that the goals or objectives of regulating countries for the purposes of combating crime and protecting the inter-connected global financial system are public interest goals of the FATF standards. Further, the purposes of regulating private businesses within countries to play a role in the combating of crime and to maintain their soundness and integrity from abuse by criminal elements are public interest goals. We say this because regulated businesses provide valuable services that can be considered as for the 'public good'. They provide professional services and products (such as banking and transactional facilities) the benefit of which is shared by society. The AML regulations focus on the services and products that these regulated businesses offer to their clients. Since these services and products are public goods, their regulation would therefore be justified, in the public interest. However, these services and products are being misused for criminal purposes. Therefore, there are some elements of 'externalities' in their provision.

The concept of 'externalities' particularly refers to the negative or unintended outcome in provision of a service or product[284]. For instance, firearm safety regulations may require firearm owners to have a firearm safe and exercise some minimum standards of care due to the dangers of firearms. In this case the 'externalities' in the services and products provided by the AML regulated businesses manifest themselves in their exploitation by criminals to launder money and conduct (criminal) transactions. Therefore, as discussed in Chapter 2, without regulation, they become unintentional or negligent facilitators of crime through allowing their services to be misused for criminal ends. Public interest theorists would therefore argue that regulation is justified to correct these externalities or market failures.

Morgan and Yeung have regarded the market failure approach as narrow in its focus. It is narrow in that it overlooks other goals and values which may be used to justify regulation[285]. Some scholars have therefore come up with more reasons as to why regulatory intervention may, in the public interest, be justified. Such 'substantive goals and values' are social and political, such as

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[284] *Ibid.*

[285] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press..

‘distributional justice’, ‘paternalism’[286] , ‘collective desires and aspirations’, ‘endogenous preferences’ and many others[287]. However one of the main problems of these substantive justifications that have correctly been pointed out is that in modern societies ‘moral disagreements and value pluralism’ may complicate the ‘substantive visions of values that regulation can legitimately pursue’[288].

This means that a universal conception of what constitutions the ‘public interest’ may be slippery[289]. However, Morgan and Yeung have suggested, as a solution to this quagmire, that such substantive goals and values might still be rescued and be made part of the regulatory agenda through adopting a more ‘procedural approach’, thus making these goals and values more acceptable to society. This procedural approach emphasises ‘deliberation, mutual interchange, dialogue and collective processes’ where various interests and sectors of society participate in defining and shaping the regulatory goals and agenda[290]. We turn, now, to look at the private interest theories which are actually a critique of the assumptions made by the public interest theories.

Private interest theories

Private interest theories emerged in response to the public interest theories in the late 1960s[291]. They are not just a critique of the public interest theories, but a critical body of thought on their own. As Anthony Ogus explains, a theory was needed to explain why regulatory

[286] Ogus, A.I. 2004. *Regulation: legal form and economic theory.* Oxford: Hart. p.26-46.
[287] See Sunstein, C. 1990. *After the rights revolution: reconceiving the regulatory state.* Boston: Harvard University Press.
[288] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press. p.36.
[289] Baldwin, R. & Cave, M. 1999. *Understanding regulation: theory, strategy, and practice.* Oxford: Oxford University Press..
[290] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press. p.36.
[291] Ogus, A.I. 2004. *Regulation: legal form and economic theory.* Oxford: Hart. p.55.

interventions that had taken place sometimes failed to fulfil the public interest of promoting social welfare[292]. While the public interest theories emphasise 'market failure' as a *prima facie* case for regulation, private interest theories, on the other hand, stress 'regulatory failure' and 'regulatory capture'[293]. Regulatory failure happens when the regulatory outcomes tend to be swayed by and to benefit narrow private interests rather than promote the collective welfare of society.

Regulatory capture happens when those charged with taking regulatory decisions abandon the collective interests of society in favour of narrow private interests of those groups who stand to benefit from the regulatory decisions. Private interest theories argue that regulation emerges from the actions of individuals or groups motivated to maximise their self-interests[294]. If particular regulatory decisions ever reflect the interest of the public, according to the private interest theories, such convergence is only accidental[295]. Like the public interest theories, there are variants of the private interest theories ranging from the economic to the political versions. According to the political versions of private interest theories, also called neo-pluralists, 'regulatory outcomes are the result of interest group pressures, in a regime in which different groups press their many different interests and concerns upon regulators"[296].

Regulators, according to this theory, 'function largely as conduits and aggregators for the preference and demands of private groups'[297]. Since private groups may have incompatible interests, they therefore compete for the regulatory decisions that would favour their own positions. Such interests may be economic and/or political. This means that regulatory decisions may not favour all the contending groups; some may emerge as winners and some as losers[298]. This

[292] *Ibid.*
[293] Morgan, B. & Yeung, K. 2007. *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press. p.43.
[294] *Ibid.*
[295] *Ibid.*
[296] Croley, S.P. 1998. *Theories of regulation: incorporating the administrative process.* Columbia Law Review, Vol. 98 (1), pp. 1-168.
[297] *Ibid.*
[298] *Ibid.*

competition may be determined by resource and influence factors[299]. Under private interest theory, the regulatory outcomes may more often than not, mirror the interests of the most powerful groups in society[300].

The economic private interest theories, or the so called 'public choice' theories, treat legislative, regulatory, and electoral institutions as an economy in which the relevant actors—including ordinary citizens, legislators, agencies, and organised interest groups most affected by regulatory policies—exchange regulatory 'goods,' which are demanded and supplied according to the same principles governing the demand and supply of ordinary economic goals[301]. According to this theory, 'firms bring to government their demands for regulation that will confer monopoly-type benefits upon them" while, on the other hand, those who make decisions (legislators, politicians and bureaucrats) confer favourable regulatory decisions in exchange for resources that will secure their positions (i.e. re-election to office)[302]. According to this 'rent-seeking' theory, as it is also referred to, politicians and bureaucrats who take regulatory decisions are seen as interested in securing their jobs or creating future career opportunities, perhaps in the same industries they regulate. Therefore, in taking regulatory decisions, they are guided by their personal, private interests.

While the private interest theories seem to focus on the national level scenario, this research also deals with matters at a global level where countries are subjects or objects of regulation by institutions they help to establish, especially in the absence of a global government. We have therefore, using the broad definition of regulation, used these theories at both global and national level to try and explain the private interests of states (as actors) and also as subjects of regulation in the emergence and diffusion of the global FATF standards. This point becomes clearer in *Chapter 5* and other subsequent chapters when we pit the publicly interested goals of the global

[299] *Ibid.*
[300] *Ibid.*
[301] *Ibid.* See also Ogus, A.I. 2004. *Regulation: legal form and economic theory.* Oxford: Hart. p.63-71
[302] Cairns, R.D. 1985. Rent-seeking, deregulation and regulatory reform. *Canadian Public Policy.* Vol. 11 (3), pp.591-601, p.592.

FATF regime with the somewhat hidden private interests of some actors in the extension of the regime throughout the globe. Having established the theoretical domain of this study as regulation, we turn to the methodology used for data collection and analysis.

South Africa as a unit of analysis

South Africa was chosen as the unit of analysis with respect to which regulatory enactment and implementation is studied. The choice was made for a number of reasons. One of the reasons was that it was one of the first developing countries to enact the FATF standards of business regulation. Since these measures were recently introduced globally and with regards to developing countries, it made good sense to select a country that had adopted these standards and had made some effort to implement them. South Africa had passed FICA, set up the FIC and regulated a variety of businesses in compliance with the global FATF standards. South Africa was also one of a few developing countries that were made full members of the FATF (in 2004) while many developing countries have so far failed to achieve this status. It is the only country in Africa that is currently a full member of the exclusive FATF club.

Another reason was based on South Africa's socio-economic conditions of a 'dual economy' which traverses both developed and developing country conditions in a very peculiar way. Emerging from apartheid into a constitutional democracy in 1994, South Africa's implementation of the FATF standards took place around this political transition. Issues of financial exclusion which arise from such aspects of AML business regulations as KYC/CDD are prone to make South Africa a "critical case" study as the majority of the country's citizens were previously and legally excluded by apartheid from participating in the economy and residentially segregated along racial and ethnic lines. Could, perhaps, the implementation of the KYC/CDD components of the global AML standards undermine social cohesion and, to some extent, stymie economic development integration of those who were previously excluded by the apartheid state?

How could these policy initiatives aimed at such noble goals of combating crime and protecting the financial system end up colliding with South Africa's post-apartheid attempt to create a more inclusive society? Another crucial factor, among others, was this researchers' familiarity with South Africa. This research is qualitative rather than quantitative in nature. It uses both primary and secondary sources of data. Of greatest importance were a series of semi-structured expert interviews conducted in South Africa between September and November 2009. As mentioned above, we examined beyond the global regime's incorporation, probing its implementation and compliance by regulated businesses as well as enforcement. By probing these outcomes, we look towards the achievement, or lack thereof, of the alleged goals/objectives of the regime.

While the effectiveness and efficiency of the regime are beyond the scope of this thesis, this project does in its focus on implementation begin to provide preliminary information in that regard. In other words, we ask whether there is evidence that the adoption of the FATF's business regulations has had any effects in detecting money laundering and counter-terrorist financing in South Africa. We have used available statistical evidence from the FIC and the FATF's mutual evaluation studies of South Africa. Our primary focus, however, remains on adoption and implementation. While the study focuses on South Africa, it is comparatively-informed as it compares, in some of its analysis of specific points, South Africa with other jurisdictions such as the US, Australia and the UK. We say more about both the interviews and the archival research and use of other secondary sources of data below.

Archival research and use of secondary sources

In collecting data for this study, we have relied heavily on archival materials as well as on secondary sources ranging from books, academic journals, newspapers, annual reports and other related studies conducted or commissioned by the relevant national (South Africa and other countries used for comparative purposes such as the UK, US and Australia), international and global institutions. These sources were consulted on their coverage of issues of money laundering, financial intelligence, organized crime and the governance or criminal justice responses to these phenomena. Among the archival and other secondary materials used were: FATF Annual Reports and Reviews on Non-Cooperating Countries and Territories; FATF Mutual Evaluation Reports; FATF's Reports on Money Laundering Typologies; reports of FATF-Style Regional Bodies; Basel Committee on Banking Supervision's Reports on Banking Regulation; Special Reports/Studies Conducted by the US's Government Accountability Office; Egmont Group's of Financial Intelligence Units Reports; FIU Reports of US, UK and Australia; legislation and case law on money laundering and asset confiscation and forfeiture from South Africa and legislative developments in the UK and US; Financial Intelligence Centre Annual Reports, Guidance Notes and Circulars; South African Reserve Bank's Banking Supervision Division Annual Reports; published research and academic articles; World Banks and IMF research and country reports relating to money laundering and observance of various governance codes and standards; South African Law Reform Commission Issue Papers, Discussion Documents and Annual Reports; South African Banking Association or Banking Council of South Africa Media Releases; Padraig O'Malley's[303] Political Interviews which are hosted by the Nelson Mandela Centre for Memory and Dialogue, a programme led by the Nelson Mandela Foundation.

Of particular help were South African parliamentary records which are recorded by the Parliamentary Monitoring Group (PMG). We drew on those relating to: parliamentary deliberations, public hearings and other standing committee processes on legislation relating to organized crime, financial intelligence, asset forfeiture and confiscation. These included minutes, audio recordings- which were transcribed by the author, written representations by interested

[303] For more about Prof. Padraig O' Malley see http://www.nelsonmandela.org/omalley/index.php/site/q/03lv01508/04lv01509/05lv01512.htm. He conducted hundreds of interviews with prominent politicians in South Africa between 1989 and 1999 where he also discussed issues of crime, organized crime and South Africa's laws dealing with these phenomena. These interviews are available through the website link above and were one of the great resources for this study.

bodies/individuals on legislative public hearings on our subject matter, particularly the parliamentary committees that handled the legislative processes of the making of the *Financial Intelligence Centre Act 2001* and the FICA Amendment Act of 2008, The *Prevention of Organized Crime Act of 1998*, *National Prosecuting Authority Act* and other relevant legislation such as POCDATARA.

Field research: semi-structured interviews

There is a dearth of academic research when it comes to the implementation, compliance and enforcement of the AML business regulations in South Africa. A decision was therefore made to supplement publicly available secondary data with a series of semi-structured expert interviews. Respondents were actors familiar with the history and current workings of the AML regime within South Africa. These persons were chosen for their unique knowledge and expertise. Semi-structured interviews were chosen because they give an expert space to reframe questions and to convey a sense of their area.

These parties were identified broadly as the regulators, regulatory supervisory bodies, regulated businesses, and law enforcement agencies. All these parties play some role in the governance of anti-money laundering and financial intelligence as given a role or legal obligations by FICA[304]. Other relevant organisations and individuals involved in or with expert knowledge of these regulations and governance in South Africa were also identified. However, not all the identified players could be reached for various reasons (see below). The objective was to select respondents whose interviews presented triangulated perspectives on the events under study. We sought out persons whose views were likely to conflict with the normally accepted views in order to gain a more comprehensive insight and to find out where we needed to dig deeper into the issues.

[304] See more on these various institution below and in Chapter 4.

Most of these interviews were conducted in the Gauteng Province - Johannesburg and Pretoria. This is because most headquarters of banks, regulatory agencies and relevant government departments are based there. Other interviews were conducted in Durban, KwaZulu-Natal. The University of KwaZulu-Natal, the Faculty of Law, graciously provided access to its facilities and the use of Library. Interview protocols were developed with key themes to be covered with the various identified sources; regulators, regulatory supervisory bodies, regulated businesses and law enforcement agencies/officers and experts.

The total number of participants formally reached during the field work was 20 (See breakdown in *Table 1* in Appendix 1.1.) and issues canvassed were dictated by the nature of the institution or the individual that was to be interviewed. This could be viewed as a good response for the study although a number of anticipated interviews did not take place. For instance, interviews were organized with the Department of Finance, a government department directly responsible for the AML regime and under which the FIC reports. With the Department of Finance, an interview was agreed upon (date, venue and time set), but on arrival we were informed that it was a mistake for the Department to agree to our interview because the Department never participates in student-led research. While we did express our disbelief in these claims, our strategy was not to compel any participant to partake in research against their will.

The Financial Intelligence Centre did not respond to numerous emails and telephone messages sent to some of its personnel, including its Director, Mr. Murray Mitchell. However on speaking to other participants about other issues, it emerged that the Director and many of his senior managers are constantly very busy, sometimes with international duties of the FATF and were constantly outside the country on such duties. Other regulatory supervisory bodies such as the Financial Services Board (FSB), the Estate Agency Affairs Board (EAAB), and Law Society of South Africa were also contacted several times without success. What compensated for not meeting anyone at the FIC were their official annual reports and reports done by the FATF and the IMF and audio recordings from their annual reports presentations to the Portfolio Committee on

Finance of the National Assembly which were found and personally transcribed by the author from the Parliamentary Monitoring Group's archives.

While the focus on business regulations was on the banking sector, an effort was made to appreciate the implementation efforts in various other sectors such as the accounting, auditing, insurance, legal, and estate agencies. Although efforts did not succeed in some industries, others were forthcoming with information, which helped this researcher to appreciate the dynamics and complexities of South Africa's implementation efforts of the FATF standards outside of the banking sector. Some complementary information was also available through other secondary sources such as media statements and written representations submitted to the South African parliament during legislative deliberations. This study could not possibly cover all these sectors in its analysis and a decision had been made prior to field work to focus on the banking sector as it affects more individuals, businesses (some of whom are regulated to comply with the AML/CTF standards) and households in the country, as they all use banking services. More reasons for choosing to focus on the banking sector are given in Chapter 6.

Selection of Respondents

Respondents were chosen by means of convenience and snowball sampling. This is a technique used where the population of persons eligible to be interviewed is unknown. In snowballing, the researcher starts with a few key contacts and, from each one, seeks the names of other knowledgeable persons who might be contacted for interviews. The researcher must take care to move beyond friendship groups and to diversify those being interviewed. In this case, the networks explored spanned several different kinds of expert. A first group of respondents were regulators. The central institution responsible for the regulation of private businesses to combat money laundering in South Africa is the Financial Intelligence Centre, which reports to the Ministry of Finance. The FIC was established in 2002 under section 2 (1) of FICA. It is headed by a Director. It shares its role of regulating private businesses for anti-money laundering purposes with various sector-specific regulatory bodies.

These sector-specific regulators are not only responsible for co-supervising AML compliance together with the FIC, but also for a range of other regulatory requirements emanating from other laws. Since the focus of this study was on banking institutions, the key supervisory body that our data collection focused on was the South African Reserve Bank's Banking Supervision Division, which is responsible for prudential regulation of all banking institutions operating in South Africa. The Banking Supervision Division is headed by the Registrar of Banks who is responsible for the overall regulation under South Africa's Banks Act, Act No. 94 of 1990. The next group was regulated businesses.

There are two forms of regulated businesses under FICA. Some are referred to as 'accountable institutions' and others as 'reporting institutions'. 'Accountable institutions' are listed in Schedule 1 of FICA and include such institutions as banks, estate agents, lawyers, brokers, casinos and many more. 'Reporting institutions' are listed in Schedule 3. The main difference between accountable and reporting institutions is that the former perform more regulatory functions than reporting institutions that are only regulated to identify and verify customers and to report suspicious and threshold transactions to the FIC. Accountable institutions do more including such functions as training staff members, appointing money laundering compliance officers and keeping records for a mandatory 5 year period[305]. In this study we refer to both accountable and reporting institutions as regulated businesses. This is merely because it is the business services and products that they provide which make them the subjects of AML regulations.

For the purposes of this study, a decision was taken to focus only on banking institutions. The reasons for choosing the banks are discussed in Chapter 6. The target for interviews was a convenient sample of the major local banks operating in South Africa, which are regulated by

[305] See Chapter 4 for more on this discussion.

FICA and its regulations, the Anti-Money Laundering Regulations (AMLRs) of 2002. Law enforcement agencies were a third group of respondents. They are, in a way, key to the administration of the AML regulations. This is simply because the FIC must feed them with financial intelligence that it collects or receives. This is expected to assist LEAs in their investigations by either initiating or providing intelligence and evidence leads on ongoing investigations[306]. A number of individuals and organisations were also identified as relevant in providing relevant information when it comes to the implementation and compliance with the AML businesses regulations. Some of these institutions included SABRIC, other supervisory bodies outside banking such as the Independent Regulatory Board of Auditors and professional associations and organisations such as the South African Institute of Chartered Accountants, the Estate Agency Affairs Board, the Financial Services Board, the Law Society of South Africa, among others, academics and expert practitioners.

The main themes covered with regulators and regulatory supervisory bodies included: understanding their role and mandate; the history of the regulatory regime and efforts made to implement it within the banking sector; the successes and challenges of implementing AML regulations in various sectors in South Africa, particularly the banking sector; and South Africa's role in ensuring compliance within the Southern Africa region and its interactions with other international bodies. The main themes covered with regulated businesses' compliance officers included the legal and regulatory requirements; how their banks have, since the coming into force of the regulations, tried to implement and comply with them; understanding the successes and challenges encountered with implementation *ab initio*; current challenges in the working of the regime; costs incurred by banks in implementing the regime since inception; organizational compliance or governance structure and the place of AML compliance within the whole 'regulatory universe' of the bank. This included such issues as various job positions and seniority, experience of staff, recruitment, training and other internal logistical and compliance issues.

[306] See Chapter 4 and 7 below for more on this.

Other themes included the working relationships between the bank and the AML regulators and the supervisory body (the FIC and the South African Reserve Bank respectively); and understanding the working relationship between the bank and the various law enforcement agencies, especially in the exchange of information needed for investigative and prosecutorial purposes. With the law enforcement agencies (LEAs), the following themes were covered; the organised crime situation in the country; the legal mandate, functions and powers of specific LEAs; organised crime related laws and opinions on their adequacy or gaps in dealing with the country's organized crime situation; organisational working relationship with the FIC and regulated businesses on issues of financial intelligence; examples of cases that have been solved through using financial intelligence emanating from the FIC; opinions on regulated businesses' compliance with the AML regulations, asset forfeiture and confiscation successes and challenges. Another important issue was the one of transformation within the criminal justice system, especially in the wake of the disbandment of the Directorate of Special Operations (DSO) by the South African government in 2009, following a resolution taken by the ANC to disband it at its Polokwane Conference in December 2007. This issue is somewhat relevant but it requires a research study on its own.

Themes covered with other actors that fell outside of the above categories were on the general crime situation in the country, particularly organized and commercial crimes; the country's political authority and will, legislative and regulatory capacity to deal with these crime phenomena; opinions on implementation, compliance and enforcement of the AML business regulations by various regulated businesses; and participant's roles or involvement in fighting crime, especially issues of money laundering.

Data Collection

Most of the secondary data was collected in libraries in London and South Africa, internet websites of organisations mentioned above and subscribed databases, particularly of the Parliamentary Monitoring Group, an organisation which monitors and records portfolio committee proceedings in South Africa. Archival research was conducted in South Africa as well. Interview data was collected through face-to-face interviews which were conducted in South Africa in 2009. The interviews were mainly of 1 hour duration, but since they were semi-structured, others took quite long, over an hour, but mostly not more than 2 hours. Many of the interviews were conducted at the offices of the participants, but others were conducted in public places such as cafes or restaurants. While some were conducted during working hours, a few took place after hours or on weekends in public places. Only one interview was conducted at a private residential home of a participant.

Data was stored in a password-protected digital recorder. All interviews were recorded, but notes were also taken by hand as a backup to occasional failures in technology. The recorded interviews were then downloaded into a password-protected hard drive for backup and were listened to and transcribed, word-for-word, by the author. This was a very laborious exercise given limited resources and also involved ethical issues. Transcription started during field research in South Africa, but a large part of it was undertaken in London.

Data Analysis

Our data analysis scheme followed the causal and interpretive approach. This entailed grouping data according to themes that helped us to test our competing hypotheses. We were trying to test the extent to which the public and private interest hypotheses explain the emergence and eventual incorporation of the regime. We were also trying to interpret how the FATF model was actually implemented or not, comparing how what was implemented differed from or conformed to what was implemented. Data analysis was continuously undertaken from the beginning of the project as the study not only relied on interviews but also upon documentary research. With field research, the first step after the interviews involved organizing and preparing data for analysis[307]. The recorded audio data was listened to several times (sometimes while travelling) and was transcribed by the author. Although time-consuming, this enabled us to reflect on the data while transcribing. Key conceptual and analytic categories were identified and data selected according to relevance to those topics. N-vivo software was considered as an option but early testing led to its replacement by a manual process.

Using typed electronic format transcripts made it easier to sort out the data later according to different themes. Most interview data is reported in Chapters 6 and 7, where it is not just used on its own, but it is presented together with other documentary data collected from various sources. Here, most of the interview data emanated from both regulated and law enforcement agencies and covered such themes as the use and management of suspicious transaction reports for law enforcement purposes.

Ethical Issues

Prior to conducting the field work, this study received an ethics approval from Kings College Research Ethics Committee under protocol number **REP-L/08/09-10**. Research ethics approval is required for all studies that involve human participants. This is done to protect the wishes of participants and their rights. Participants in this research participated either as representatives of institutions or in their individual capacity. They were handed out an 'information sheet' which explained the basic purposes of the research and their role in the study. It also informed them that their participation was voluntary and that they were under no obligation to

[307] Creswell, J. 2003. *Research design: qualitative, quantitative and mixed methods approach*. London, UK: Sage Publications, p. 191-195.

participate in the study. We also gave them an opportunity to withdraw their participation from the study at any time before a specified date (February 2010). None of the participants withdrew from the study. They were assured of the confidentiality of their identities in any publications produced.

The participants were given the information sheet to keep - with contact information of the researcher and of Kings College London. They were also made to sign a ‘consent form’ authorizing the recording of interviews and the keeping and usage of their data in this study and subsequent publications by this researcher. During the data collection phase there was a perception on the part of this researcher that issues of money laundering and financial intelligence are often regarded as highly secretive when some of them are clearly not, especially issues covered by this research which mainly had to do with governance rather than money laundering and specific financial intelligence itself. The public perceptions of secrecy made many of my informants to elect not to be referred to by name in any publication. They also wished that no structural information be provided that could lead a reader to deduce their identities. We have, nonetheless, respected this wish.

Conclusion

In this Chapter we located the study within the domain of regulation, discussing the concept of regulation and the competing regulation theories of public and private interest. We then weaved these theories, which were also used to develop our research hypotheses, with the research methodologies and also discussed our case study research design. The research methods used in this study use a causal and interpretive logic that relied largely on documentary and interview data. In the next Chapter we begin to describe the AML legal, regulatory and institutional framework in South Africa.

Chapter 4

South Africa's AML/CTF regime: laws, regulations and institutions

Introduction

The fight against the proceeds of crime, or money laundering, has become synonymous with the fight against organised crime in many countries where legislative and policy measures, are underpinned by a philosophy that organised criminals commit crime primarily and mainly for financial gain. In other words criminals are seen as entrepreneurs and their organisations as enterprises. In a similar way that legitimate businesses that do not make profits collapse, the solution goes; criminals should be made insolvent and liquidated through such schemes as asset confiscation and forfeiture. As a result of such reasoning, one of the key strategies used by many governments in fighting organised crime has been to attack the criminal proceeds through seizing them.

In this chapter we describe the legal, regulatory and institutional framework that South Africa has developed to deal with organised crime, money laundering and terrorist financing. The main focus is on the laws, regulations and institutions/agencies that South Africa has put in place or given powers to in order to deal with these issues of crime. It has sometimes been argued that the country's problem of organised crime, or its increase, could most probably be explained through the country's transition from apartheid to democracy in 1994[308]. However, a look at the legislation developed, starting from 1992 onwards, does not suggest this to be the case. Instead, legislative developments show a pattern similar to that in many other neighbouring countries that

[308] See Irish, J. & Qhobosheane, K. 2005. Penetrating state and business: organised crime in Southern Africa. In P. Gastrow. Pretoria, Institute of Security Studies. Shaw, M. 1998. *Organised crime in post-apartheid South Africa*. Occasional Paper, Safety and Governance Programme: Pretoria: Institute of Security Studies. Gastrow, P. 1999. Main trends in the development of South Africa's organised crime. *African Security Review,* Vol. 8(5).

did not have apartheid rule[309]. We start by taking an historical look at the development of the offence of money laundering as a central strategy or technique of dealing with organised crime in South African law. Building from that, we then look at the legal, regulatory and institutional framework that has been developed over the years.

Problems in the struggle against organised crime

South Africa's organized crime situation was generally viewed as having escalated following the country's transition from apartheid to democracy[310]. There were, at the same time, issues of weakness of institutions and lack of a comprehensive statutory framework to fight organised crime[311]. It was argued that criminal laws on their own were very weak to deal with organised groups who made large profits from their crimes[312]. While some laws existed to try and deal with the problem of both drug-related crimes and money laundering they were regarded as outdated and as not bringing South Africa into line with the *UN Vienna Convention against Illicit Drugs and Psychotropic Substances of 1988*[313]. This led the new South African government to embark on a concerted legislative drive to reform both the institutions and the laws that would be

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[309] For instance, many South Africa's neighbouring countries passed their money laundering laws before South Africa. In Botswana, the Proceeds of Serious Crime Act no 19 of 1990 criminalised the laundering of property derived from serious crime. The Zimbabwean Serious Offences (Confiscation of Profits) Act no 12 1990 did the same as the Botswana law. In Zambia, the Dangerous Drugs (Forfeiture of Property) Act no 7 of 1989 criminalised the laundering of drug proceeds. Other Countries include, Tanzania's Proceeds of Crime Act no 25 of 1991, Gambia's Drug Control Act of 1993 and Nigeria's Money Laundering Decree of 1995. See Smit, P. (2001). *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Pretoria: Institute of Security Studies., Vol.51, pp.23-24.

[310] Irish, J. & Qhobosheane, K. 2005. Penetrating state and business: organised crime in Southern Africa. In P. Gastrow. Pretoria, Institute of Security Studies. Shaw, M. 1998. *Organised crime in post-apartheid South Africa*. Occasional Paper, Safety and Governance Programme Pretoria: Institute of Security Studies. Gastrow, P. 1999. Main trends in the development of South Africa's organised crime. *African Security Review*, Vol. 8(5).

[311] See *Padraig O'Malley's Interview with Willie Hofmeyr,* 08 August 1998. http://www.nelsonmandela.org/omalley/index.php/site/q/03lv00017/04lv00344/05lv01183/06lv01224.htm

[312] See, for instance, SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf

[313] See *O'Malley's Interview with Dullar Omar*, 11 March 1997. http://www.nelsonmandela.org/omalley/index.php/site/q/03lv00017/04lv00344/05lv01092/06lv01102.htm

used to fight organised crime. Central to these reforms were new laws which were aimed at criminalizing the possession, exchange or use of proceeds of crime. With these new laws, new state institutions were also introduced to ensure implementation and enforcement. Below, we look at the development of these laws.

The criminalisation of money laundering in South African law

The offence of 'money laundering' in South African law was formally introduced by the Drugs and Drug Trafficking Act, (Act 42 of 1992, hereinafter referred to as the Drugs Act). In the Drugs Act, the offence of money laundering only addressed the proceeds of drug-related offences. It should be noted that even at a global level, this was the trend at that time. The UN and the FATF initially sought the criminalisation of possession, use or exchange of drug-related crime proceeds. In 1996, the new South African democratic parliament passed legislation known as the Proceeds of Crime Act, (Act 76 of 1996, hereinafter referred to as the PCA). The PCA broadened South Africa's legislative focus on money laundering beyond the drug-related offences to include all types of predicate offences. However, a much broader overhaul of South African law was soon introduced by the Prevention of Organised Crime Act of 1998 (hereinafter referred to as the POCA), which introduced 'civil forfeiture' of proceeds of crime (see later below). This piece of legislation repealed the money laundering provisions of the Drugs Act and incorporated the whole of the PCA. Alongside the POCA, another key legislation known as the Financial Intelligence Centre Act of 2001 (or FICA) was promulgated.

These two statutes, POCA and FICA, form the backbone of South Africa's current legal and regulatory framework against organised crime and, as shall be shown below, focus on a central strategy of attacking the proceeds of crime. They also brought into line the country's legal and institutional systems with the recommendations of the FATF. Alongside POCA and FICA, it is also important to mention the enactment of the National Prosecuting Authority Act of 1998 (hereinafter referred to as the NPAA). This is because it was in the NPAA where some critical law enforcement institutions to enforce the provisions of POCA were set out. In speaking of such institutions we refer to such bodies as the Asset Forfeiture Unit, the then Directorate of Special Operations (popularly known as the Scorpions, now disbanded) and the office of the National Director of Public Prosecutions, who exercises extensive powers given to him by POCA (see later below). There are also a number of other enactments that complement POCA and FICA such as the Extradition Amendment Act (Act No. 77) of 1996, the International Cooperation in Criminal Matters Act (No. 75) of 1998, the Protection of Constitutional Democracy Against Terrorist and Related Activities Act (No. 33) of 2004 (hereinafter referred to as the Terrorism Act of 2004), and the Prevention and Combating of Corrupt Activities Act (No. 12) of 2004. Below, we start by discussing the provisions of POCA. In doing so, we also discuss legislation that it amended or was amended by, such as the PCA, the Drugs Act of 1992 and others mentioned above.

Prevention of Organised Crime Act, 1998

POCA was enacted to introduce measures to combat organised crime and money laundering[314]. It provides for: 'the prohibition of money laundering'; 'recovery of proceeds of unlawful activity'; and 'civil forfeiture' of criminal property that has been used to commit an offence or 'instrumentalities of crime'[315]. It also provides for 'civil forfeiture' of 'property that is proceeds of unlawful activity' or property that is 'owned or controlled by, or on behalf of, an entity involved in terrorist and related activities'[316]. POCA further provides for the establishment of the 'Criminal Assets Recovery Account'. It also amended the Drugs Act of 1992, and repealed the PCA by incorporating its provisions, although with some modifications (see below)[317]. POCA came into force in January 1999 and below we discuss in some detail some of its key provisions.

[314] See the long title of POCA.
[315] See *Ibid.*
[316] *Ibid.*
[317] *Ibid.*

General money laundering offences

POCA does not define money laundering[318], but creates two sets of offences that prohibit it, namely: 1. offences involving 'possession, use or exchange' of 'proceeds of unlawful activity' and 2. offences involving 'possession, use or exchange of proceeds of a pattern of racketeering activity'[319]. Offences involving 'proceeds of unlawful activity' are found in Chapter 3 of POCA, while offences involving a 'pattern of racketeering activity'[320] are dealt with in Chapter 2 of POCA.

Offences relating to 'proceeds of unlawful activity'

The first set of money laundering offences is crimes involving the proceeds of unlawful activities. Section 1 of POCA defines the 'proceeds of unlawful activity'[321] as 'any property or any service advantage, benefit or reward which was derived, received or retained in connection with or as a result of any unlawful activity carried on by any person'[322]. Such proceeds could have been 'derived, received or retained, directly or indirectly, in the Republic or elsewhere', and 'at

[318] 'Money laundering' or 'money laundering activity' is defined by FICA as 'any activity which has or is more likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds and includes any activity which constitutes an offence in terms of s 64 of [FICA] or section 4, 5, or 6 of [POCA]'.
[319] See POCA. See also De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime. Johannesburg: Rand Afrikaans University. p.4.
[320] POCA does not define what is meant by 'racketeering activity', but defines a 'pattern of racketeering activity'. 'A 'pattern of racketeering activity' means 'the planned, ongoing, continuous or repeated participation or involvement in any offence referred to in Schedule 1 (of POCA) and includes at least two offences referred to in Schedule 1, of which one of the offences occurred after the commencement of POCA and the last occurred within 10 years (excluding any period of imprisonment) after the commission of such prior offence referred to in Schedule 1.
[321] See POCA, definitions.
[322] See Kennedy, A. 2006. Designing a civil forfeiture system: an issues list for policymakers and legislators. *Journal of Financial Crime*, Vol. 13(2), 132-163, p.133. Kennedy compares the legislation from countries that have introduced the civil forfeiture proceedings. Such countries include South Africa, Ireland, the UK, Fiji, the Canadian provinces of Ontario. Alberta, Manitoba, Saskatchewan and British Columbia, Australia and its individual states, Antigua and Barbuda and the Commonwealth. Kennedy opines that the definition of 'proceeds of unlawful activity' in South African law is probably the widest of all.

any time before or after the commencement' of POCA[323]. These provisions put an emphasis on the extraterritoriality and retrospective nature of the offence of money laundering (see below). The basis for extraterritoriality appears to emanate from the fact that POCA is also directed at fighting transnational crime as money laundering and organized crime are regarded, in the preamble of POCA, as 'international security threats' which require South Africa to adopt 'extra-territorial' measures to deal with them[324]. This could also be explained in line with South Africa's international obligations of co-operation with other countries in the fight against transnational crime as a signatory to the UN Vienna Convention of 1988 and as a country that has committed itself to comply with the FATF standards.

The issue of retrospective application of the 'proceeds of unlawful activity' definition, and other aspects of POCA, was raised in the *Carolus*[325] judgment in 1999. The initial definition of the 'proceeds of unlawful activity' did not make provisions for the retrospective nature of some parts of POCA, leading to the state losing some of its early applications for forfeiture[326]. The state, in the *Carolus* case, appealed against two decisions in the lower courts dismissing its applications for forfeiture orders of criminally acquired property on the grounds that such property was acquired before the commencement of POCA. POCA was mute on this issue. This led Judge Farlam AJA, at paragraph 31 *Carolus* judgment, to reject the NDPP's appeal as follows:

> ...no statute is to be construed as having retrospective operation (in the sense of taking away or impairing a vested right acquired under existing laws) unless the legislature clearly intended the statute to have that effect…

As a result of this adverse decision for the state, the words "...at any time before or after the commencement of this Act…" were added to the definition of 'proceeds of unlawful activity'

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[323] See POCA. See also De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime. Johannesburg : Rand Afrikaans University..
[324] See POCA preamble.
[325] See *National Director of Public Prosecutions of South Africa v Carolus.*
[326] See *Ibid.*

and other provisions, in the POCA Amendment Act of 1999. 'Unlawful activity' is defined in POCA as 'conduct which constitutes a crime' or 'which contravenes any law of South Africa'[327]. This definition makes the reach of POCA very wide as many offenses which are actually minor misdemeanours and not organised crime are also covered. For instance, it is a criminal offence to drive a vehicle while under the influence of alcohol in many countries. However such conduct could hardly be categorized as constituting organised crime, but merely as a traffic offence. One major question has been whether traffic offences should also be regarded as organised crime or not for purposes of forfeiting cars of drunken drivers as 'instrumentalities of an offence'[328]. We return to this later but for now we are still on the POCA definition of 'unlawful activity' which is 'conduct which constitutes a crime' or 'which contravenes any law of South Africa'. POCA provides that such conduct may have occurred before or after the commencement of POCA and may have occurred within South Africa or elsewhere (thus emphasizing the retrospectivity and extraterritoriality of POCA).

POCA broadly defines 'property' as 'money or any other movable, immovable, corporeal or incorporeal thing and includes any rights, privileges, claims and securities and any interest therein and all proceeds thereof'[329]. An additional definition of 'property' was added to POCA in 2003 following South Africa's enactment of the Terrorism Act (POCDATARA). This additional definition defines 'property associated with terrorist and related activities' as property which

a) 'was acquired, collected, used, possessed, owned or provided for the benefit of, or on behalf of, or at the direction of, or under the control of an entity which commits or attempts to commit or facilitate the commission of a specified offence as defined in the Protection of Constitutional Democracy Against Terrorist and Related Activities Act, 2004; or

[327] See POCA
[328] See, for instance, the case of *National Director of Public Prosecutions v Van Staden.*
[329] See *Ibid.*

b) has provided financial or economic support to an entity in the commission or facilitation of an offence referred to in paragraph (a)'.

Offences specified as relating to 'proceeds of unlawful activity' are covered in Section 4 of Chapter 3 of POCA which provides that a person 'who knows' or 'ought reasonably to have known' that 'property is or forms part of the proceeds of unlawful activities, commits an offence if he enters into any agreement [whether such agreement is legally binding or not], arrangement or transaction in connection with the property or performs any other act in connection with the property which has the effect or is likely to have the effect of

(i) 'concealing or disguising the nature, source, location, disposition or movement of the property or the ownership of the property or any interest in that property; or

(ii) enabling or assisting any person who committed an offence to avoid prosecution or to remove or diminish any property acquired as a result of an offence'[330].

Secondly, an offence is also committed if a person 'knows or ought to have reasonably known that another person has obtained the proceeds of unlawful activities and enters into any transaction, agreement or arrangement in terms of which

(i) 'the retention or control by or on behalf of that other person of the proceeds of unlawful activity is facilitated; or

(ii) the proceeds are used to make funds available to that person, to acquire property on his behalf, or to benefit him in any other way'[331].

Another money laundering offence is also committed, under Section 6, if a person 'acquires, uses or possesses property' and that person 'knows' or 'ought reasonably to have

[330] See POCA.
[331] *Ibid.*

known' that 'such property is or forms part of the proceeds of unlawful activities of another person'[332].

In the above Chapter 3 offences, there is a recurrence of the phrases 'knows' or 'ought reasonably to have known'. This denotes that these offences, as Smit has correctly pointed out, can only be committed by a person 'who knows' or a person 'who ought reasonably to have known' that the property concerned constituted the proceeds of unlawful activities[333]. As Smit says, the definitions of these phrases in POCA leave no doubt that the criteria required to establish guilt would be either 'intent' or 'negligence'[334]. POCA states that in order to determine this 'knowledge', a person 'knows' if he/she 'has actual knowledge of the fact' or the court is satisfied that;

i) 'the person believes that there is a reasonable possibility of the existence of that fact, and

ii) he or she fails to obtain information to confirm the existence of that fact.' (omission)

In other words, 'an individual who believes that there is a possibility that the property dealt with is the proceeds of criminal activities, but turns a blind eye to the possibility, may expose him/herself to criminal liability'[335]. A person 'ought reasonably to have known or suspected a fact if the conclusions that he or she ought to have reached are those which would have been reached by a reasonably diligent and vigilant person having both:

i) the general knowledge, skill, training and experience that may reasonably be expected of a person in his or her position; and

332 *Ibid.*
333 See Smit, P. (2001). *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Pretoria: Institute of Security Studies., Vol.51, pp.24-37.
334 *Ibid.*
335 *Ibid.*

ii) the general knowledge, skill, training and experience that he or she in fact has[336].

As noted by Smit, the definition of 'ought reasonably to have known' emphasizes the negligence aspect of the offence of money laundering[337]. This places a duty of diligence on every person or organization that may be at risk of coming into contact with the proceeds of criminal activities[338]. This means that regulated persons and businesses under FICA, as discussed later, are duty bound to acquire the knowledge, skill and experience and to undergo the training that will be necessary to identify situations where they may be dealing with the proceeds of crime. This duty, as Smit puts it, requires that persons or organizations 'constantly apply their acquired knowledge, skill and training and experience to ensure that they are alert when coming across something out of the ordinary or suspicious'[339].

Offences relating to 'proceeds of a racketeering activity'

The second set of money laundering offences relate to proceeds of a 'pattern of racketeering activity'[340] which is defined in POCA as a 'planned, ongoing, continuous or repeated participation or involvement in any offence referred to in Schedule 1'[341] of POCA. Such participation or involvement should include at least two offences listed in Schedule 1, of which one of the offences should have occurred after the commencement of POCA and the last offence must have occurred within 10 years (excluding any period of imprisonment) after the commission of such prior offence. Schedule 1 of POCA lists a number of such predicate offences such as fraud, kidnapping, robbery, extortion and many others. The offences relating to the proceeds of a pattern of racketeering activity are contained in Chapter 2 of POCA. This chapter, among other things,

[336] *Ibid.*
[337] *Ibid.*
[338] *Ibid.*
[339]*Ibid.*
[340] See POCA.
[341] See Schedule 1 of POCA for scheduled offences.

provides for offences relating to 'receipt, use or investment' of proceeds of a pattern of racketeering activity.

Assets Forfeiture

One of the main objectives of POCA is to prevent criminals or anyone else (except the state) from benefiting from the proceeds of criminal activities[342]. (Many of the cases referred to here are summarized in Appendix 4.1.). In the *R O Cook Properties*[343] case Judges Mpati DP and Cameron AJA, sum up (at par 18) the purposes of POCA as interrelated and including (a) removing incentives for crime; (b) deterring persons from using or allowing their property to be used in crime, (c) eliminating or incapacitating some of the means by which crime may be committed ('neutralising' property that has been used and may again be used in crime) and (d) advancing the ends of justice by depriving those involved of the property concerned. In another judgment O' Reagan ADCJ of the Constitutional Court of South Africa, confirms the general understanding of purposes of asset forfeiture laws. She says the two main purposes of these provisions are: 1. 'deterrence: to ensure that people are deterred in general from joining the ranks of criminals by the realisation that they will be prevented from enjoying the proceeds of the crime they may commit', and 2. 'prevention: the scheme seeks to remove from the hands of criminals the financial wherewithal to commit further crime'[344].

We argued that these instruments of asset forfeiture and the whole scheme of fighting organized crime through criminalization of proceeds reflect a particular approach to crime prevention; the situational crime prevention approach as made popular by Ronald Clarke in the 1970s and 80s (see *Chapter 2* above). These inter-related purposes as outlined by Mpati DP and Cameron AJA of the Supreme Court of Appeal and O'Reagan ADCJ, at the Constitutional Court

342 See POCA preamble.
343 See *National Director of Public Prosecutions v R O Cook Properties.*
344 See par 52 of *S v Shaik*.

are consistent with various UN conventions aimed at fighting organized crime and the FATF standards. A related sentiment that flows from the judges' analysis of POCA's provisions for asset confiscation and forfeiture is that their primary purpose is not to punish offenders. O'Reagan ADCJ sums this up succinctly where she says that the 'primary purpose seems rather to be to ensure that criminals cannot enjoy the fruits of their crimes'[345]. She adds that 'it may well be that the achievement of this purpose might at times have a punitive effect, but that is not to say that the primary purpose is punitive'[346].

Consistent with the purposes referred to above, the provisions contained in Chapter 5 and 6 of POCA provide for the forfeiture of proceeds of unlawful activities and 'instrumentalities of an offence'. Chapter 5 provides for the 'restraint'[347], 'confiscation'[348] and 'realisation'[349] of property constituting the proceeds of crime. Chapter 6, on the other hand, provides for 'preservation' and 'forfeiture' of proceeds of unlawful activity and 'instrumentalities of an offence' (see later). Chapter 5 is used where a defendant in a criminal case has been charged and is subsequently convicted of a criminal offence, while Chapter 6 requires no criminal charge/conviction. The latter means that criminal property or property that has been 'concerned in' the commission of a crime may be seized without convicting or even charging anyone with a criminal offence (see discussion of 'instrumentalities of an offence' below).

POCA states that all asset forfeiture procedures in South Africa are 'civil proceedings', whether invoked in terms of Chapter 5 or Chapter 6. This means that in these proceedings, the standard of proof that needs to be satisfied is 'on the balance of probabilities' that the property to be confiscated or forfeit is more likely to be the benefit from proceeds of an offence or instrumentalities. All these proceedings are mainly initiated by the National Director of Public Prosecutions or his subordinates, through his/her written consent. The institution responsible for

[345] See par 57, *ibid.*
[346] See par 57, *ibid.*
[347] See POCA.
[348] *Ibid.*
[349] *Ibid.*

asset forfeiture in South Africa is the Asset Forfeiture Unit, which was established in 1999[350]. The initial proceedings of restraining or preserving, freezing and confiscating of property take the form of an *ex parte* application brought by a prosecutor before a judge. Below we look at the provisions of Chapter 5 (restraint, confiscation and realisation orders) and then Chapter 6 (preservation and forfeiture orders).

Restraint, confiscation and realisation orders

Restraint, confiscation and realisation orders are provided for in Chapter 5 of POCA, which deals with conviction-based forfeiture of proceeds of unlawful activity. The conviction-based forfeiture is tied to a parallel criminal case. This means that forfeiture can only be successfully finalised (in favour of the State) once there is a criminal conviction in that case and other processes such as appeals have been finalised. The process of seizing assets could be initiated prior to or at any time during the course of the criminal proceedings, but before sentencing. There is a number of ways in which conviction-based forfeiture proceedings, in terms of Chapter 5, may commence. There are however two main ones which POCA provides for. These are restraint and confiscation orders.

POCA empowers the National Director of Public Prosecutions (NDPP) to make an *ex-parte* application to a High Court for a restraint order of property representing the value of benefit the defendant might have enjoyed from his or her criminal activities[351]. These are criminal activities he/she is about to be charged for, or has already been charged for or has been convicted of. Restraint orders effectively freeze the property concerned. When the NDPP applies for a restraint order, s/he seeks relief that prohibits the defendant or anyone else 'from dealing in any manner with any property' which may later be realised or paid to the state as proceeds of his/her

[350] See discussion on the Asset Forfeiture Unit below.
[351] See Section 25 of POCA.

criminal activity. The purpose here is to ensure that such property does not disappear or get disposed of by the defendant or anyone else prior to the finalization of the criminal trial and the confiscation proceedings. There are a number of issues arising out of restraint orders. These include, for the most part, practical issues of living and legal expenses of the defendant and his family or dependants[352].

Section 26 (6) (a) allows the court to make an order to provide for use of some restrained assets for 'reasonable living expenses' of the respondent and 'his or her family or household'. Provision is also made for 'reasonable legal expenses'[353]. The respondent/defendant may apply to the court for the provision of these expenses. The court must also be satisfied that the respondent cannot meet his/her legal or living expenses without access to property that is under restraint. This means therefore that the respondent must as part of his or her request make a 'full disclosure' of all his assets and liabilities under oath[354]. One other issue that has been litigated was the issue of rights of creditors of defendants whose property has been frozen, which was settled by the Constitutional Court in *Fraser vs. ABSA Bank Limited*. The question was whether or not the defendant (Fraser) could be allowed access to the frozen property even if that jeopardised ABSA's concurrent claim on the frozen property. Judge Van Der Westhuisen held that the court had discretion to allow the defendant access to frozen property for reasonable legal expenses and such should not be 'ring-fenced' on the claims of concurrent creditors, turning down the decision of the Supreme Court of Appeal[355].

When a criminal trial has been finalized and the accused is found guilty, the court making a conviction may, in terms of section 18 of POCA enquire into whether a benefit was derived from the offences or from other related criminal activity. If, after the section 18 enquiry, the court finds that the defendant did indeed benefit, it may order payment to the state of any amount it considers

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[352] See s 26 (6) of POCA.
[353] See *Ibid.* s 26 (6) (b).
[354] See *Ibid.* s 26 (6).
[355] See *Fraser v ABSA Bank Limited*, par. 77-79.

appropriate. A confiscation order, therefore, is a 'civil judgment for payment to the state of an amount of money determined by the court'[356]. It is 'additional' to criminal sanctions which 'a court may impose following a criminal conviction'[357]. O' Reagan ADCJ, correctly points out that the order that a court may make in terms of Chapter 5 of POCA 'is not for the confiscation of a specific object, but an order for the payment of an amount of money to the state'[358]. For instance, the defendant may fulfil a confiscation order by using other means of payment instead of having his restrained property executed against.

One of the thorny issues with confiscation orders has been the issue of determining the amount of benefit that should be confiscated. For instance in *S v Shaik* [359], the Constitutional Court had to decide on an appropriate amount to be forfeit following Mr. Shaik's conviction on corruption charges. Shaik and his group of companies were, as the court found, corruptly given shareholding which earned them dividends over a period of time. The question was whether the net amount (value) of shareholding or the dividends as well should be confiscated. O'Reagan ADCJ held that POCA permits that all benefits that have arisen from the commission of a crime, whether directly or indirectly, may be confiscated by the trial court after a conviction. She further held that the trial court has discretion to determine the appropriate amount in any given case. Confiscation orders, as mentioned above, are civil judgments for payment to the state of amounts of money determined by the court. When this order is made, the respondent would, normally, pay such an amount as directed by court. Failure to do so would ultimately result in the state seeking a relief through a 'realisation' order.

A 'realization order' is practically an execution order. The use of a realisation order would ordinarily flow from the defendant's failure to comply with a confiscation order. In other words, the defendant's failure to pay the state the amounts the court has determined as benefits from

[356] See par 24 of *S v Shaik and Others*
[357] *Ibid.*
[358] *Ibid.*
[359] *S v Shaik and Others*

criminal activities s/he has been convicted of. The main question around the realisation of property orders is what property can be sold to satisfy a confiscation order. 'Realisable property' means any property held by the defendant concerned or by any other person on his or her behalf[360]. This is property in which the defendant has an interest. It could be his/her house, car, shareholding in companies, savings or anything of value that could be used or sold to pay for his/her debt as in normal civil proceedings.

This goes further to include property that the defendant has given to third parties, i.e. friends, family, even if such property was given to them as gifts. For instance, if the defendant had bought a house and registered it in the name of his/her spouse or another family member, such property could be executed against as an 'affected gift'[361]. POCA defines, in section 12 (1), an 'affected gift' as any gift made by the defendant concerned not more than 7 years before the institution of his/her prosecution or the institution of a restraint order application, whichever is earlier. The idea of affected gifts was meant to get around the hiding of criminal property by registering or keeping it under the names of third parties such as family, friends and private companies or other legal entities. Having looked at POCA Chapter 5 proceedings, particularly restraint and confiscation orders-- which are triggered by criminal charges and convictions, now we turn to look at Chapter 6 proceedings—which do not rely on criminal charges or convictions.

Non-conviction based preservation and forfeiture orders

Both preservation and forfeiture orders apply to the '*in rem'* forfeiture proceedings and are found in Chapter 6 of POCA. The 'i*n rem'* asset forfeiture orders are non-conviction based and are claimed to be against property, rather than a person. They do not depend on the charging or conviction of the respondent (or owner of such property). This means that any property could be

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[360] See POCA, s 14 (1) (a) (b) (c).
[361] See POCA, Section 12(1).

seized and forfeit to the state without charging anyone with any criminal offence, but by just proving, on balance of probabilities, that such property was instrumental in the commission of an offences by anyone, typically the target of an investigation or that such property is likely to be the proceeds of unlawful activity (including terrorism financing).

Not all jurisdictions with asset forfeiture laws use the non-conviction based forfeiture mechanism[362]. There are currently a few countries that are reported to be using this system. These include the United States, some provinces of Canada and Australia (South and West), the UK, Fiji, South Africa and a few other countries[363]. However there are reports that many other countries are looking at adopting the non-conviction based forfeiture regimes, which are highly recommended by FATF. While the conviction-based forfeiture system, as discussed above, is controversial, it is eclipsed by the controversy of the non-conviction based forfeiture system in countries that run this model. In countries like the United States it has provoked extensive lobbying, leading, according to Gupta, to some toning down in US laws including especially the enactment of the Civil Asset Forfeiture Reform Act of 2000[364].

In South Africa, preservation orders serve a similar purpose as restraint orders. Their aim is to preserve property from being disposed of pending the finalization of forfeiture procedures. POCA gives the NDPP powers, under Section 38, to make an *ex parte* application for an order 'prohibiting any person from dealing in any manner with any property'. The High Court can issue such an order if it has 'reasonable grounds to believe' that the property concerned; is 'an instrumentality of an offence', is the 'proceeds of unlawful activities' or is 'associated with terrorist and terrorist-related activities'[365]. This order must specify what is to happen to the property while it gives a chance to all affected parties to contest the order or subsequent forfeiture.

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362 See Kennedy, A. 2006. Designing a civil forfeiture system: an issues list for policymakers and legislators. *Journal of Financial Crime,* Vol. 13(2), 132-163

363 *Ibid.*

364 See Gupta, D. 2002. Republic of South Africa's Prevention of Organised Crime Act: A comparative Bill of Rights Analysis. *Harvard Civil Rights-Civil Liberties Law Review*. Vol. 37, pp.159-183.

365 See POCA, Section 38.

The court may, therefore, order that such property be taken custody of by a police officer or be placed under the administration of a receiver or *curator* while these processes unfold. POCA gives the courts discretion to vary or rescind a preservation order on application by any party affected by it[366]. The grounds for such rescindment or variation could be that the operation of the order will 'deprive the applicant of the means to provide for his or her reasonable living expenses' and may 'cause undue hardship'[367].

Further, the onus is on the applicant(s) to show that the hardship s/he may suffer, as a result of the order, 'outweighs the risk that the property concerned may be destroyed, lost, damaged, concealed or transferred'[368]. Preservation orders expire in 90 days from the date in which they are granted, but are extendable through a new application to the issuing court. It is within this period of 90 days in which the NDPP, through the Asset Forfeiture Unit, must apply for a forfeiture order. The granting of a preservation order does not automatically or always translate into the granting of a forfeiture order. Protracted battles between those affected by these orders and the state usually ensue, as loosing property may not be a generally pleasant experience. Asset freezing and restraint orders are heavily litigated, according to Adv. Hofmeyr, who explained to us that

> "It's just a problem that when you take people's money, they would, frankly, rather spend the money paying lawyers to fight you than just to surrender meekly…It is still a frustration of how much of the money that's frozen ends up being used up in litigation. In other countries the courts have started being serious about limiting how much can be used [on legal expenses] but our courts are still quite generous."

A forfeiture order serves the same purpose as a confiscation order under POCA's Chapter 5 proceedings**.** In making a forfeiture order a court may exclude some interests if it finds on the balance of probabilities that the party contesting the order had acquired the property concerned

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[366] See POCA.
[367] *Ibid.* s47 (1) (a) (i).
[368] See *Ibid.* s47 (1) (b) (ii).

legally and did not know or had no reasonable grounds to suspect that such property had been used to commit crime, or was proceeds of a crime or associated with terrorist activities[369]. However, the onus is on the respondent to convince the court on the balance of probabilities. This has become known as the 'innocent owner defence', following Judge Ackerman J's reference in the *Mohamed case*[370]. The court makes a forfeiture order if it finds that, on 'balance of probabilities', the property concerned is an 'instrumentality of an offence', or 'proceeds of unlawful activities', or is associated with terrorist and related activities[371].

There is a difference between a confiscation order in terms of Chapter 5, and a forfeiture order in terms of Chapter 6 of POCA. While in terms of Chapter 5, a confiscation is not tied to any particular property, but on the value or amount of benefit that the defendant might have enjoyed as a result of criminal and associated criminal activities s/he had been convicted of, a forfeiture order is tied to a particular property. The NDPP must prove on 'balance of probabilities' that a particular or a specific property concerned is 'proceeds of unlawful activity' or is an 'instrumentality of an offence'. The courts have gone to great lengths in trying to clarify both these concepts as provided for in POCA. Three particular Supreme Court of Appeal judgments stand out in the clarification of these concepts: the *NDPP v R O Cook Properties Limited*[372], the *NDPP v 37 Gillespie Street Pty (Ltd) and another*[373] and the *NDPP v Seevnarayan*[374]. All these three judgments were handed down as a single judgment in the Supreme Court of Appeal by Judges Mpati DP and Cameron JA. They concerned appeals by the NDPP after various High Courts refused to grant the NDPP with forfeiture orders on the grounds that he had failed to prove that: the properties concerned were 'instrumentalities of offences', and had not succeeded in proving either that they were 'proceeds of unlawful activity'.

[369] See *Ibid.* s 52 & 54.
[370] National Director of Public Prosecutions v Mohamed NO .
[371] See Section 50 of POCA.
[372] *National Director of Public Prosecutions v R O Cook Properties.*
[373] *National Director of Public Prosecutions v 37 Gillespie Street Durban.*
[374] *National Director of Public Prosecutions v Seevnarayan*.

While the NDPP appeals failed at the Supreme Court of Appeal (SCA), these three cases provide the guiding principles of the court's interpretation of both these phrases; the 'instrumentality of an offence' and 'proceeds of unlawful activity'[375]. The court's interpretation draws the line on what the authorities may cause to be forfeit and what they may not. This is because it appears that the authorities in South Africa, with the coming into force of POCA, have been overzealous, seeking to lay their hand on any property (even where it is unrelated to organised crime), including vehicles, as instrumentalities of an offence of driving under the influence of alcohol[376]. This seeming over-interpreting of forfeiture laws by the AFU has had the effect of net-widening. For reasons of space we are unable to discuss the court's interpretation of the proceeds of unlawful activity in the main text. We however attach **Appendix 4.2.** for our analysis of these two concepts of 'instrumentality of an offence' and of 'proceeds of unlawful activity'.

Criminal Asset Recovery Account (CARA)

Chapter 7 of POCA provides for the establishment of a Criminal Assets Recovery Account (or CARA), within the national revenue fund[377]. It is in this CARA account where all moneys derived from the fulfilment of confiscation and forfeiture orders and proceeds of foreign forfeiture orders as contemplated in the International Co-operation in Criminal Matters Act of 1998 are finally deposited. Chapter 7 also provides for the establishment of a Criminal Assets Recovery Committee. This Committee, among other things, advises the Cabinet on the utilization and allocation of funds in the CARA account (see the section on Asset Forfeiture Unit below for the amounts deposited in the CARA account and Chapter 7 on general AFU statistics).

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[375] See Appendix 4.2. for a discussion of these cases and the interpretation by the courts of the concepts of 'instrumentality of an offence' and 'proceeds of unlawful activity'. We have put them in the Appendix for reasons of space.
[376] See for instance, *National Director of Public Prosecutions v Van Staden.*
[377] See POCA.

POCA's amendment of laws

Other issues worth noting about POCA are that it repealed a number of provisions from the Drugs Act of 1992 and also that it repealed and incorporated the whole of the Proceeds of Crime Act of 1996. POCA also amends some parts of the International Co-operation in Criminal Matters Act of 1998. Since it came into force in 1999, it has been amended by about six pieces of legislation[378]. Below we look briefly at those important legislative enactments that POCA either amended or repealed before going on to look at the ones that significantly amend it.

Drugs and Drug Trafficking Act of 1992

The Drugs Act[379] remains in force, having had some of its parts amended not only by POCA, but also by the now repealed Proceeds of Crime Act of 1996. Since the latter Act was repealed, the provisions that related to the Drugs Act got incorporated into POCA, although with improvements or variation. As mentioned elsewhere above, the Drugs Act of 1992, which came into operation on 30 April 1993, was the first South African legislation to introduce the offence of money laundering into South African law. However, money laundering activities, according to the Drugs Act, only related to proceeds of specific drug-related offences. This mirrored the narrow pattern of similar developments of anti-money laundering laws at a global level,

Up until 1990, only a few countries such as the United States, Australia and the UK had criminalized the laundering of proceeds of serious crimes other than drugs. The Drugs Act also provided for the reporting of suspicious transactions involving the proceeds of drug-related offences. According to this Act, a director, manager or chief executive officer of a financial

[378] POCA is amended by *POCA Amendment Act 24 of 1999*, *POCA Second Amendment Act 38 of 1999*, the *Financial Intelligence Centre Act 38 of 2001*, the *Prevention and Combating of Corrupt Activities Act 12 of 2004*, the *Protection of Constitutional Democracy against Terrorist and related Activities Act 33 of 2004*, *Criminal Law (Sexual Offences and Related Matters) Amendment Act 32 of 2007*, and *the Criminal Law (Sentencing) Amendment Act 38 of 2007.*
[379] See *The Drugs and Drug Trafficking Act, Act No. 140 of 19*92

institution was obliged to report his/her suspicions to a designated police officer of the South African Police Service[380]. The financial institutions obliged to report were banks, insurance companies, stock brokers and traders in financial instruments[381]. Another major new contribution of this Act was its provision for mechanisms for the restraining and confiscation of such proceeds by the police. Also important to note is the potential extra-territoriality of the offences relating to proceeds of drug-related crimes. The Drugs Act also provided for international assistance regarding the enforcement of foreign confiscation orders in respect of the proceeds of drug-related offences.

There are a number of weaknesses that were identified in the Drugs Act[382]. The first and most obvious one is that it was only confined to drug-related crimes[383], while organized criminals did not so confine themselves. The second is that the reporting regime introduced by the Drugs Act was only confined to financial institutions, while a number of other non-financial institutions could be used to launder criminal proceeds. According to the South African Law Commission, the Drugs Act did not provide any comprehensive measures through which money laundering could be controlled or combated[384]. According to Pieter Smit, now a senior manager at the Financial Intelligence Centre, the Drugs Act, by 2001, had not produced a single money laundering conviction[385].

This has been attributed to capacity problems in the South African Police Service and an absence of a coordinated transaction reporting and related regulatory scheme in the form of a

[380] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf, SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Discussion Paper 64*, Pretoria. http://www.justice.gov.za/salrc/dpapers/dp64_prj104_1996.pdf, SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Report*, Pretoria. http://www.justice.gov.za/salrc/reports/r_prj104_1996aug.pdf

[381] *Ibid.*

[382] *Ibid.*

[383] *Ibid.*

[384] *Ibid.*

[385] See Smit, P. (2001). *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Pretoria: Institute of Security Studies., Vol.51.

financial intelligence unit[386]. The South African Law Commission was delegated to look into how South African law could be reformed in order to provide for a comprehensive legislative, institutional and regulatory scheme for dealing with money laundering[387]. The Law Commission came up with two consultative papers in 1996 that would later lead to the enactment of the *Financial Intelligence Centre Act of 2001* (see Chapter 5).

Proceeds of Crime Act of 1996

The *Proceeds of Crime Act of 1996* (or PCA) extended the offence of money laundering to non-drug related predicated crimes, such as common law and other statutory offences[388]. It also provided for the freezing, confiscation and forfeiture of the proceeds of all types of crimes. The PCA provided for a general reporting obligation for businesses coming into possession of suspicious property. This reporting obligation extended the reporting net beyond financial institutions to include every individual in charge or involved in a business undertaking, which was indeed very broad and lacked clarity in various aspects. The PCA did not handle many applications as it was soon repealed and incorporated (with some amendments) into POCA of 1998. Before it was repealed, its forfeiture procedures were used at least three times[389]. However, an institutional regulatory scheme such as a financial intelligence unit was lacking[390]. This was only rectified when the *Financial Intelligence Centre Act of 2001* was enacted—establishing, for the first time in South Africa, a financial intelligence unit as envisaged in the FATF standards.

[386] See *Ibid.* See also SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf
[387] See *Ibid.*
[388] See *The Proceeds of Crime Act, Act No. 76 of 1996*
[389] See Smit, P. (2001). *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Pretoria: Institute of Security Studies., Vol.51.
[390] *Ibid.*

Financial Intelligence Centre Act, 2001

While all the other Acts discussed above are mainly concerned with criminalizing money laundering and providing for confiscation and forfeiture of proceeds and instrumentalities of crime, the *Financial Intelligence Centre Act of 2001* (hereinafter referred to as FICA) supplemented such objectives by establishing the institutional and regulatory framework for South Africa's regime against money laundering. FICA, while it amended POCA, also complemented it in a number of ways. It was enacted in order to establish the Financial Intelligence Centre (FIC) and the Anti-Money Laundering Advisory Council (AMLAC) in order to combat money laundering activities and the financing of terrorist and related activities[391]. It imposes certain duties on private businesses and persons who might be used for money laundering purposes and terrorist financing[392]. It also creates a number of criminal offences for failure to comply with the obligations it creates. For all the obligations that FICA creates, there are corresponding offences which are backed by custodial sanctions or punitive fines which run to millions of rands. However it is important to note that all these criminal custodial sentences and heavy fines seem to have been provided for as a last resort so that they are there when the authorities need to use them in order to enforce compliance and to encourage cooperation or instead to make an example of some regulated bodies or individuals who show a cavalier attitude or laxity towards compliance.

Unlike POCA where there is a growing body of case law, FICA's criminal provisions remain largely untested in South Africa. There has only been one case where the FICA provisions achieved a conviction[393]. Even this conviction did not flow from a contested prosecution but rather from a plea-bargain agreement[394]. FICA came into force on February 2002, although some of its

[391] See the long title of FICA. From now on, for ease of reading, I drop the phrase 'and related activities' when referring to financing of terrorism, unless otherwise stated. This is not done to impute the dropped phrase, but for ease of writing and reading. We also use the phrase 'terrorist financing' and 'financing of terrorism' interchangeably.
[392] See FICA.
[393] Financial Intelligence Centre. 2008. *Annual Report 2008,* Pretoria, p. 4. These convictions were a result of a plea bargain agreement in *S v Maddock Incorporated and Another* (0) [2008] ZACOMMC 1 (1 February 2008). Retrieved from: http://www.saflii.org/za/cases/ZACOMMC/2008/1.html
[394] *Ibid.*

provisions only came into effect in 2003, five years after POCA was enacted. Chapter 1 of FICA makes provisions for the establishment of the Financial Intelligence Centre (FIC), and Chapter 2 provides for the establishment of the Anti-Money Laundering Advisory Council (AMLAC). Chapter 3 outlines the Anti-Money Laundering Control measures while Chapter 4 establishes a number of offences and penalties. We start by discussing Chapter 1 provisions. Since Chapter 1 provides for the creation of FIC, we merely outline what the law provides for. Later in this chapter, we discuss the institutions it established and those that interact with its provisions.

Financial Intelligence Centre

Section 2 of FICA establishes the FIC as 'an institution outside the public service but within the public administration as envisaged in section 195 of the Constitution of South Africa[395]. As a result of this constitutional caveat, the FIC is one of several independent administrative bodies reporting to the Minister of Finance, but enjoined by Chapter 10 of the Constitution to uphold the administrative values embedded in it. The principal objective of FIC is to assist in the identification of proceeds of unlawful activities and the combating of money laundering activities and terrorism financing[396]. The second objective of the Centre is to make the information it collects available to investigating agencies, intelligence services and the South African Revenue Service for law enforcement purposes[397]. The last main objective is for the Centre to exchange information with similar bodies in other countries regarding money laundering activities and similar offences[398].

The Act also provides for the functions[399] of the FIC, which are to:

a) process, analyse and interpret information disclosed to it and obtained by it within its operational mandate;

[395] The Constitution of the Republic of South Africa, Act No. 106 of 1996, section 195.
[396] Section3 (1) of FICA.
[397] *Ibid.* Section 3 (2) (a).
[398] *Ibid.* Section 3 (2) (b).
[399] *Ibid.* Section 4.

b) inform, advise and cooperate with investigating authorities, supervisory bodies, the South African Revenue Service and the intelligence services;

c) monitor and give guidance to accountable institutions, supervisory bodies and other persons regarding the performance by them of their duties and their compliance with FICA provisions; and

d) retain the information it collects or receives.

Section 5-16 provides for general powers of FIC ranging from the appointment of its staff and its head to its responsibilities, security screening of staff, management of funds and accountability mechanisms as an independent body[400].

Anti-Money Laundering Advisory Council

The Anti-Money Laundering Advisory Council (or AMLAC) is established in terms of section 17 of FICA. Its functions are to advise the Minister of Finance, under which the FIC falls, on policies and best practice to identify the proceeds of unlawful activities and to combat money laundering activities. AMLAC is tasked with advising the Minister of Finance on discharging his/her powers as entrusted in him/her by FICA[401]. The Council is further charged with advising the FIC concerning the performance of its functions. AMLAC is supposed to act as a forum in which the FIC, associations representing categories of regulated businesses, organs of state and supervisory bodies can consult one another[402]. The FIC is expected to provide AMLAC with administrative and secretarial support.

AMLAC is made up of the FIC Director and the executive heads of the following state agencies: the National Treasury, South African Police Services, Department of Justice and

[400] *Ibid.* Section 5.
[401] See FICA.
[402] *Ibid.* Section 18.

Constitutional Development, the National Prosecuting Authority, the National Intelligence Agency, South African Secret Service and the South African Revenue Services. It is also composed of representatives of the various categories of regulated businesses, supervisory bodies or any other bodies as nominated by these groups and requested by the Minister of Finance. The Minister of Finance appoints the chairperson of AMLAC from these representatives.

Regulatory supervisory bodies

The supervisory bodies are industry regulators responsible for industry-wide regulation of their sectors. They were given powers by FICA to co-supervise AML /CTF compliance of their specific industries or professions with the FIC. FICA lists only 8 Supervisory Bodies in Schedule 2 of the Act. These are the Financial Services Board which supervises various types of financial services providers; the South African Reserve Bank which is responsible mainly for banks and foreign exchange dealers; the Registrar of Companies, the Estate Agency Affairs Board - real estate agencies, the Independent Regulatory Board of Auditors (IRBA) - for auditors, National Gambling Board - for casinos, the Law Society of South Africa for legal professionals and the JSE Securities Exchange for securities and commodity dealers. This Schedule of supervisory bodies is outdated as it refers to bodies which do not exist anymore (such as the Public Accountants and Auditors Board, which was replaced by the Independent Regulatory Board of Auditors (IRBA)) and required or was in the process of getting amended during our field work[403]. While FICA gives these bodies functions to supervise regulated businesses, it initially did not give them powers to enforce compliance[404]. However, the FICA Amendment Act of 2008 has, according to the FIC, closed this gap by giving supervisory bodies more powers to ensure compliance within their

[403] *Author Interview with Adv F Opperman of Independent Regulatory Board of Auditors(IRBA), 23 October 2009*.
[404] See preamble of the FICA Amendment Act of 2008.

various sectors. However, the Amendment Act seems to have been met with some stiff opposition by some supervisory bodies and regulated businesses[405].

It is important to mention that there are a number of regulated businesses or professions which do not have a supervisory body under FICA. One of these involves motor vehicle dealers, who do not have an industry-specific regulatory authority that can be appointed under FICA to supervise them. Even with those FICA regulated industries with supervisory bodies, there are some challenges. For instance attorneys are regulated by their provincial law societies, which are not listed as supervisory bodies under FICA but only the Law Society of South Africa -- a national body which does not supervise lawyers directly but through autonomous provincial societies.

Money Laundering Control Measures (AML business regulations)

Consistent with its objective of imposing certain duties on institutions and other persons who might be used for money laundering and terrorist financing, Chapter 3 of FICA sets out measures to control money laundering. It is divided into five parts. Part 1 deals with the duty to identify clients, part 2 with the duty to keep records, part 3 with reporting duties and access to information and part 4 with measures to monitor compliance by 'accountable institutions'. Part 5 deals with the referral of suspicious transactions to investigating agencies and with the supervision of 'accountable institutions' by the supervisory bodies and the FIC. The obligations imposed by FICA on regulated businesses or 'accountable institutions' are detailed in the *Anti-Money Laundering Regulations of 2001* (as amended) which complement FICA.

It is the regulatory functions that FICA and its regime imposes on private businesses that are at the core of this research. This is because it is these control measures which are the AML business regulations in South Africa. These control measures are FATF-inspired. They require

[405] See discussion of the FICA Amendment Act of 2008.

private businesses to perform quasi-policing functions in order to help in detecting money laundering and terrorism financing. We have made an appendix[406] of a discussion of these regulations as they are discussed in Chapters 6 and 7. These are regulatory duties to: identify clients and verify their residential addresses (KYC/CDD); mandatory keeping of records for extended periods of time; report various types of customer transactions to the Financial Intelligence Centre; establish internal compliance systems which include the training of staff and; appoint compliance officers[407]. Failure to comply with any of these duties is a criminal offence and may lead to fines and custodial sentences against employees. These offences and penalties are covered in Chapter 4 of FICA, sections 46 to 71[408].

FICA amended a number of pieces of legislation, but particularly POCA. The main provision of a duty to report transactions was incorporated into FICA from section 7 of POCA, removing such duty from POCA. This duty had been inherited by POCA from the *Proceeds of Crime Act of 1996* and the Drugs Act of 1992. In FICA, this duty to report transactions is accompanied by comprehensive regulatory obligations for businesses such as staff training, record keeping, appointment of compliance officers and so on. FICA has also been amended by two pieces of legislation; the POCDATARA (Terrorism Act of 2004) and the *Financial Intelligence Centre Amendment Act of 2008*.

Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004

One event that led to the passing of this Act was the twin-tower bombings in the US on September 11 2001. After these bombings, the UN Security Council made a resolution prompting its member countries to fight international terrorism and its financing[409]. The Financial Action

[406] See Appendix 4.3.
[407] See Appendix 4.3. for a discussion of the regulatory obligations of regulated businesses.
[408] See FICA for these offences.
[409] *UN Security Council Resolution 1373 of 2001*, 28 September 2001.

Task Force also added nine special recommendations urging its members and other countries to incorporate the terrorism measures within their anti-money laundering legislation. The underlying reasoning for this, as expressed by the FATF, is that terrorists (although their motivations are not primarily profit making) use legitimate businesses like profit-motivated criminals in order to finance their activities, cleanse funds and move them across borders. As a result of this, they should be monitored and reported on like organized criminals, by private businesses. In response to these global developments and South Africa's first mutual evaluation[410] by the IMF and the FATF, the South African parliament passed the Terrorism Act in 2004. What this Act does is to append the responsibilities of fighting terrorist financing into FICA and its regulations. It also appends these responsibilities to POCA's asset forfeiture regime.

Financial Intelligence Centre Amendment Act, 2008

The *Financial Intelligence Centre Amendment Act of 2008* (or FICA Amendment Act) was initiated by the Centre through a discussion document circulated in 2006[411]. There were a number of concerns which the IMF and the FATF raised in their first mutual evaluation of South Africa which required some enactment and improvement[412]. These pointed to loopholes in the administration, compliance and enforcement mechanisms of South Africa's AML regime[413]. The FIC published a discussion document in 2006 which pointed to lack of adequate powers to encourage and enforce compliance with the regime. The amendments create more powers for the supervision and enforcement of compliance which were considered lacking from the original Act.

[410] International Monetary Fund. 2004. *South Africa: Report on the Observance of Standards and Codes-FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*. IMF Country Report No. 04/119, April 2004, Washington DC

[411] See FIC. 2006. *Proposed amendments to the Financial Intelligence Centre Act , 2001*. Discussion Paper. Pretoria: Financial Intelligence Centre..

[412] See International Monetary Fund. 2004. *South Africa: Report on the Observance of Standards and Codes-FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*. IMF Country Report No. 04/119, April 2004, Washington DC

[413] See *Ibid.*

Amongst the changes is the introduction of administrative sanctions for non-compliance by regulated businesses[414].

In ensuring compliance, the Amendment Act provides for the appointment of inspectors and provisions for inspection of regulated businesses[415]. This is done in order to ensure and enforce compliance by regulated businesses. It also gives the supervisory bodies and the Centre sanctioning powers in the form of both non-financial penalties and fines[416]. It also provides for the lodging of appeals following administrative sanctions[417] and creation of an Appeals Board[418], where regulated businesses can contest the regulatory decisions and fines imposed on them. The Amendment Act was gradually phased in from 2010. However, during its enactment it faced some open opposition from some regulated businesses and supervisory bodies in the public hearings in parliament[419]. There were also complaints about proposed enforcement fines and the general broadening of the role of the FIC[420]. So far we have focused on the legislation. We now turn to institutions that have been given powers, functions and roles to implement, ensure and enforce compliance with South Africa's regime.

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[414] Financial Intelligence Centre. 2008. *Annual Report 2008*, Pretoria, p.21.
[415] FICA Amendment Act of 2008, s 45A (a) & (b).
[416] *Ibid.* Section 45C
[417] *Ibid*. Section 45D
[418] *Ibid*. Section 45E
[419] See submission made by IRBA to the Portfolio Committee on Finance on 30 April 2008 entitled "*Comments and recommendations on the proposed Financial Intelligence Centre Amendment Bill, 2008*". In this submission IRBA, among other things, highlighted potential conflicts of regulatory duties in the proposed FICA Amendment Bill, specifically with regards to amendments to give the FIC more powers to enforce compliance without the involvement of an industry-specific supervisory body. In this regard IRBA wrote that "...it was of great concern that a non-auditing body [FIC] will have the power to override a considered decision taken by the statutory regulator of the profession [IRBA]."
[420] See submission made by IRBA (ibid.), the Law Society of South Africa entitled "*Financial Intelligence Centre Amendment Bill- Submission by the Law Society of South Africa"* Submission to the Portfolio Committee on Finance, (5 May 2008).

Institutional framework

This section seeks briefly to discuss the regulatory players in South Africa's AML regime. In discussing POCA and FICA above, a number of players have emerged. However, only two institutions were discussed above; the FIC and AMLAC. Below we start to outline the regulatory and institutional framework more broadly, albeit not exhaustively, to encompass all bodies that have a role in the implementation of the laws and regulations against money laundering and terrorist financing in South Africa[421]. The first group of these role-players includes new institutions specifically created by FICA. As discussed above, these are the FIC and AMLAC and the Regulatory Supervisory Bodies of regulated institutions or persons.

The second group of institutions involves those that receive or request information from the FIC for purposes of investigations, law enforcement, prosecutions and asset forfeiture[422]. These institutions are comprised of traditional law enforcement agencies of South Africa; the South African Police Services (SAPS). They are also made up of specialized units in the National Prosecuting Authority such as the Directorate of Special Operations (now disbanded and replaced by the Directorate of Priority Crimes Investigations (DPCI) which falls under the SAPS) and the Asset Forfeiture Unit. Among these groups of institutions are also the country's national intelligence/security institutions such as the National Intelligence Agency, which covers domestic security threats and its counterpart, the South African Secret Service, which covers external security threats and interests.

Another institution in this cluster is the South African Revenue Service (SARS). Foreign financial intelligence units can also be classified under this group of institutions as they can share

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[421] See De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime. Johannesburg: Rand Afrikaans University. for more on South Africa's institutional framework for combating money laundering.

[422] See FICA, as amended, Section 3 (a) which provides for the FIC "to make information collected by it available to investigating authorities, supervisory bodies, the intelligence services and the South African Revenue Services to facilitate the administration and enforcement of the laws of the Republic"

information with South Africa's FIC[423], especially where they have signed agreements (such as Memorandums of Understanding or Mutual Legal Assistance Treaties) for such information sharing. The last group is the regulated businesses and the reporting institutions that must comply with FICA and FIC Regulations. Above we have already discussed FIC and AMLAC. We will now discuss the second group of institutions which is the investigating agencies who use the information they receive from the FIC for law enforcement purposes.

South African Police Service

The SAPS is charged with the general functions of policing and investigating any crime within the republic of South Africa. However due to the specialized nature of many offences, the South African Police Services has got various specialized units within itself. For instance, it has detective branches that investigate organised crime. These are the Commercial Branch, the Organised Crime Branch and the Serious and Violent Offences Branch. All these are supported by the Crime Intelligence Division which is responsible for crime intelligence gathering and analysis.

A Proceeds of Crime Investigation Desk was established at the Commercial Branch Head Offices in Pretoria on January 2002 to receive, evaluate, analyse and distribute the Suspicious Transaction Reports and other relevant information referred to it by the FIC[424]. A new specialized division was formed within the SAPS, known as the Department of Priority Crime Investigations (or DPCI). The DPCI, also known as 'the Hawks,' was established in 2009/10 following the disbandment of the Directorate of Special Operation of the National Prosecuting Authority.

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[423] See *Ibid.* Section 3 (b) which provides for the FIC to "exchange information with bodies with similar objectives in other countries regarding money laundering activities, the financing of terrorist activities, and other similar activities"
[424] De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime. Johannesburg: Rand Afrikaans University.

South African Receiver of Revenue

SARS is one of the supervisory bodies under FICA. While the main task of the revenue services is the collection of taxes, it also investigates violations of the revenue laws. It forms an important pillar of South Africa's fight against money laundering, especially when it comes to the predicate offence of tax evasion. See more discussion of SARS in Chapter 7.

National Prosecuting Authority (NPA)

The National Prosecuting Authority is an independent state body established in terms of the National Prosecuting Authority Act of 1998. The NPA and its statute are contemplated in section 179 of the Constitution of South Africa, which provides for the establishment of a single prosecuting authority for South Africa. Before 1994, South Africa had a fragmented system of prosecutions headed by regional Attorney's General. The latter system was viewed as lacking in centralized coordination and policies. It was phased out with the introduction of the NPA. The NPA is headed by the NDPP. There are four very important components of the National Prosecuting Authority that need to be mentioned in relation to South Africa's AML regime. First of these is the NDPP and the National Prosecution Service. There are also two units located within the NPA which are the Asset Forfeiture Unit and the former Directorate of Special Operations.

National Director of Public Prosecutions

The NDPP is supported by four deputy National Directors of Public Prosecutions and Directors of Public Prosecutions who are appointed for each seat of the High Court throughout the nine provinces of South Africa. The deputy national directors of public prosecutions head various specialized units under the NPA. These components include the National Prosecution Service, which normally services the various courts of the country with day-to-day prosecution of all types of crime. The second deputy headed the former Directorate of Special Operations, which was a specialized unit formed in 1999 to investigate and prosecute organised crime and corruption. The third deputy heads the Asset Forfeiture Unit and the last one is responsible for personnel and other special projects. The position of the NDPP is very senior within the criminal justice system since s/he is responsible for prosecution of all criminal offences on behalf of the state. POCA gives the NDPP a number of exclusive powers, which s/he may delegate to subordinates as permitted by the law. S/he is appointed by the president of the country for a renewable period of seven years.

Asset Forfeiture Unit (AFU)

The AFU was established in 1999, under the office of the NDPP. It was specifically established to implement Chapters 5 and 6 of POCA. We have, at length, discussed the provisions of these Chapters of POCA. The AFU was formed to ensure that the powers given to the NDPP to seize proceeds of crime are used to their maximum effect to combat especially organised crime[425]. The AFU drafts all the paperwork that is used in the civil proceedings to seize the proceeds or instrumentalities of crime. It liaises and works with the investigating agencies and prosecutors to identify all cases where asset forfeiture procedures should be considered or have commenced. Detectives from the South African Police Services are seconded to work in the AFU offices with the intention of identifying and bringing potential cases from their units to the AFU's attention, conducting financial investigations and preparing court applications for them in conjunction with prosecutors.

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[425] While the focus of Asset Forfeiture laws, as contained in POCA focus on organised crime, the AFU has been very adventurous is seeking to develop the law. For instance some of their forfeiture proceedings have been applied to what may be deemed as, albeit serious, traffic offences. The *National Director of Public Prosecutions v Van Staden and Others* judgment concerned an application by the NDPP to forfeit a vehicle of a drunken driver as an instrumentality of an offence.

Since its formation, the AFU has been headed by Adv. Willie Hofmeyr[426], a deputy NDPP. The AFU has prioritized two major strategic objectives; 1. to develop the law through test cases and to create legal precedents that allow for the effective use of the new asset forfeiture laws and, 2. to increase its volume of cases to enable itself to make a real impact against organised crime[427]. In a report to Parliament in 2008, Adv. Hofmeyr detailed the successes of the unit. Since 1999, the AFU has established offices in all the nine provinces of South Africa, increased its volume of cases[428] and seized assets worth millions of Rands[429] and has also made deposits to the Criminal Asset Recovery Account (CARA)[430]. For the first time, in 2008, the funds in the CARA were paid out to various law enforcement agencies and to organizations and causes supporting the victims of crime[431].

Most of the AFU cases emanate from the South African Police Services[432]. The rest arose from the South African Receiver of Revenue and the Directorate of Special Operations investigations. DSO investigations contributed more than 60% (monetary) value of all the seized

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[426] Adv. Willie Hofmeyr, before being appointed as the Deputy National Director of Public Prosecutions, was a member of parliament for the ruling African National Congress. He was a member of the Justice and Constitutional Development Parliamentary Committee. The latter Committee was very key in the development and passing of POCA, the legislation which gives powers to his office to seize proceeds of crime.

[427] *National Prosecuting Authority's Annual Report Presentation to Parliament, 2008*: Asset Forfeiture Unit Presentation by Willie Hofmeyr.

[428] See *Ibid.* According to Hofmeyr, by May 2008, South African courts had handed down 235 court judgements on issues of asset forfeiture, with the AFU winning 159 (67% of 235) of these cases. 22 of these had been handed down, after appeal by the Supreme Court of Appeal (through which the AFU succeeded in 13 cases) and 6 had been made by the Constitutional Court, the highest court, after further appeals from decisions made by the Supreme Court of Appeal. Of the 6 decision made by the Constitutional Court, the AFU succeeded in 5. However, it appears that in the first 4 years, from 1999 to April 2003, the AFU won only 25 of 52 judgements. The performance seems to have improved from 2003 onwards (to 2008), leading to successes in 133 of 182 judgements, that is 73% favourable judgements.

[429] *Ibid.* In 2006/7 financial year, the AFU seized assets worth R1, 297m (US $ 144m at US$1.00=ZAR 9.00), forfeit assets worth ZAR 101m. In 2007/8, ZAR345m worth of assets were seized, and forfeit ZAR 127m. The value of seized assets would naturally be higher than the value of assets forfeit since seized assets are pending the finalization of forfeiture proceedings and have therefore not been realised.

[430] *Ibid.* In 2006/7 and 2007/8 financial years, ZAR 19m and ZAR 49m were respectively deposited into the CARA.

[431] *Ibid.* The victims of crime supported by the CARA funds may not directly or necessarily be victims of organised criminal activities. For instance some of the beneficiaries are the Truth and Reconciliation Commission Victims, Centre for Rape Crisis and Battered Woman, specialised equipment for sexual offences courts, among others.

[432] See *Chapter 7* below for more on AFU's statistics on restraint, preservation, confiscation and forfeiture orders.

assets, despite its 13% share of cases compared to the 83% of cases emanating from the South African Police Services.

Directorate of Special Operations (DSO) ('Scorpions')

The DSO was established, like the AFU, in 1999 under former President Thabo Mbeki's administration. In his first State of Nation address to parliament in 1999, Mbeki announced that a specialised and adequately staffed and equipped investigation's unit was to be established urgently to deal with all national priority crimes[433]. It would later appear that the national priority crimes that Mbeki referred to were mainly organised crime and corruption, following from the conceptualization of the DSO. While Mbeki made the announcement in June, in July the Minister of Justice announced the formation of the DSO to start operating in September 1999. When the DSO started operating, it existed through various presidential proclamations, up until 2001 when it was legally established and officially accommodated within the National Prosecuting Authority, through the National Prosecuting Authority Act of 1998.

Section 7 of the NPA Act established the Directorate of Special Operations as a unit within the NPA. The objectives for the establishment of the DSO as contained in Section 7 (1) (a) of the NPA Act were to: (i) investigate, and to carry out any function incidental to investigations, (ii) gather, keep and analyse information; and (iii) where appropriate, institute criminal proceedings and carry out any necessary functions incidental to instituting criminal proceedings relating to:

(aa) offences or any criminal or unlawful activities committed in an organized fashion; and

(bb) such other offences or categories of offences as determined by the President by proclamation in the Gazette.

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[433] *Address of the President of the Republic of South Africa, Thabo Mbeki's at the Opening of Parliament.* National Assembly, Cape Town, 25 June 1999.

Section 7 (1) (b) of the NPA Act defined crimes that are committed in an ‘organized fashion’ as encompassing planned, ongoing, continuous or repeated participation, involvement or engagement in at least two incidents of criminal or unlawful conduct that have the same or similar intents, results, accomplices, victims or methods of commission, or otherwise related by distinguishing characteristics.

The DSO, as contemplated in the NPA Act was led by a deputy National Director of Public Prosecutions, assisted by an Investigating Director, who were both appointed by the President. These officials were given a number of statutory powers by the NPA Act and reported directly to the NDPP. The Investigating Director was given powers to institute and conduct investigations where s/he had reason to suspect that a ‘specified offence’[434] had been or was being committed[435]. Another manner in which an investigation could be instituted was through referrals by the NDPP[436]. The DSO did not last for more than 10 years as it was disbanded by the ruling African National Congress through a conference resolution taken in its Polokwane Conference in December 2007. This disbandment followed from accusations, among others, that the DSO was selectively targeting leaders of the ANC in its corruption investigations[437]. One such leader who was supposedly targeted[438] was the current president of the ANC and country, Jacob Zuma, who had been charged with several counts of corruption, racketeering, and money laundering. There were strong views from my respondents that the DSO was used by a faction, within the ANC, that was linked to the then President Thabo Mbeki, to target his deputy, Jacob Zuma in a race for the leadership of the ANC and the country.

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[434] A specified offence is defined as any matter which in the opinion of the Head of the DSO falls within the range on matters contemplated in s 7 (1) (a) and subsections. See *The National Prosecuting Authority Act, Act. No. 32 of 1998*
[435] *Ibid.* s 28 (1) (a)
[436] See *Ibid.* s 28 (1) (b).
[437] There are many other issues that were cited as reasons for the disbandment of the DSO. Such reasons included claims that the unit was from its formation captured or infiltrated by former apartheid security branch officers who had a vendetta with the leadership of the ANC. It is impossible to cover all these issues as they are beyond the scope of this work. However, at one point the Secretary-General of the ANC, Gwede Mantashe, made a striking comparison in which he claimed that the similarity between the Democratic Alliance, South Africa’s main opposition party, and the DSO was that they both hated the ANC. *SABC TV News 2009*.
[438] *Author Interview with a former Chief Investigations Officer of the former DSO, September 2009*

> “Too many people within the ANC were being investigated by the Scorpions [DSO], that’s the problem. It fed this campaign; it was a major factor feeding the campaign against Mbeki because Mbeki was seen to be close to [Adv. Bulelani] Ngcuka[439]…and this relationship was seen to be driving the prosecution of [Jacob] Zuma. It was seen to be driving the prosecution of [Ngoako] Ramathlodi[440] and various other people. So it was about “we are being persecuted and Mbeki is using the Scorpions to persecute us”…So I don’t know but to me, certainly it was a platform… because one prominent Zuma supporter told me, while we were talking about the events leading up to [the ANC Conference in] Polokwane that if it wasn’t for that persecution, Zuma probably would not have been president. So it was like everybody thought this poor man was being persecuted by the Scorpions and there is nothing like persecution to get a lot of people to sort of fighting for you.”[441]

Another participant echoed similar sentiments.

> “My personal view is that the DSO was used as a political pawn and I am being very honest here…If you look at the race for power [within the ANC] and you look at the association of [Leonard] McCarthy[442], look at the association of certain other individuals, having a direct line to the President [Mbeki] in terms of the timing of when to arrest and place before court president Zuma. That in my view constituted interference.”[443]

The general feeling was that this ‘capture’ of law enforcement institutions for narrow, factional political ends was damaging to the criminal justice system. However, most of the

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[439] Adv. Bulelani Ngcuka is the former National Director of Public Prosecutions and the Head of NPA. He was therefore the ultimate Head of the DSO as it was of the units of the NPA

[440] Ngoako Ramatlhodi is of the member of the National Executive Committee a senior member of the ANC and is former Premier of the Northern Province (Lipompo].

[441] *Author Interview with Marry De Haas, August 2009.*

[442] Leonard McCarthy was the Head of the DSO at the time a decision was taken to disband it.

[443] *Author Interview with a former Chief Investigations Officer of the DSO, September 2009*

participants felt that it was too drastic of the ANC and government to disband the DSO following the ANC's Polokwane Conference of December 2007. One of my interviewees said the move to disband the DSO was a radical one.

> "One would have imagined that if there were problems within the organisation [DSO], such problems would be identified and dealt with…If there were people…they would have been identified and dealt with… They [DSO] did of course a lot of good work, good cases, tackling obviously your big targets that had a financial muscle, you know, to withstand and fight. They were really under pressure for a long time. They were really under pressure because of the cases that they carried. So really, what is important for me would be, you know, whichever formation is set up will be as effective as the DSO was, but I can tell you now that this is one setback that, you know, is going to take a while to fix."[444]

When the decision to disband the DSO was made by the ANC, they were eventually disbanded. The charges against Zuma were eventually withdrawn by the then acting NDPP, Adv. Mokotedi Mpshe, after the incumbent (Adv. Vusi Pikoli), was mysteriously suspended[445]. Adv. Pikoli, in fighting for his reinstatement as NDPP at the Ginwala Commission of Inquiry which had been set up to determine his fitness to hold office, argued that it was his refusal to take political instructions from the former President Mbeki and the former Minister of Justice, Bridgette Mabandla, on some criminal matters which led him to be unceremoniously suspended[446] and eventually dismissed[447].

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[444] *Author Interview with a Deputy Director of Public Prosecutions, October 2009*

[445] Mail & Guardian Online. *Rumours swirl over Pikoli suspension*. 30 September 2007. http://mg.co.za/article/2007-09-30-rumours-swirl-over-pikolis-suspension

[446] See *Report of enquiry into the fitness of Advocate VP Pikoli to hold office of National Director of Public Prosecutions*. November 2008. Ginwala Commission. http://www.pmg.org.za/files/docs/081208GinwalaReport.pdf

[447] Mail & Guardian Online. *Pikoli removed from office, vows to fight back*. 17 February 2009. http://mg.co.za/article/2009-02-17-pikoli-removed-from-office-vows-to-fight-back

The disbandment of the DSO was highly challenged by opposition parties and other sectors of society. One Hugh Glenister, a private citizen and businessman, opened a case where he challenged the government's disbandment of the DSO as unconstitutional and in contravention of South Africa's international obligations to have a specialized and independent corruption fighting agency[448]. He argued that the DSO was independent and was more effective in fighting organized crime and corruption as compared to the police. He further alleged that the ANC-led government had disbanded the DSO in order, among other things, to protect corrupt cadres and interests within its ranks. A general view therefore was that the disbandment of the DSO was "a less great idea", "emotional", "took the country several steps back" and was largely influenced by "bad motives at various times"[449].

> "…the fact that the DSO was effective in corruption cases did become part of the motive [for their disbandment]. There was a chorus of people who were being investigated who did not want the DSO there and hoped that their cases would go away…I think the Hawks (DPCI) will face the same pressure in a couple of years' time."[450]

In 2011, the Constitutional Court heard the Glenister case and handed a split judgment, with the majority of judges finding in Glenister's favour and directed parliament to take corrective measures to ensure that the new Directorate for Priority Crime Investigation (and nicknamed the Hawks), was independent from political influence and interference[451]. The Constitutional Court found that the legislation that established the Hawks was constitutionally invalid and gave parliament 18 months to rectify it[452]. The disbandment of the DSO did, according to some interviewees, have some impact in crime investigations as, for instance, most of the high value cases of the AFU came from the DSO in terms of assets frozen or seized. I asked Adv. Knox

448 *Glenister v President of the Republic of South Africa and Others.*
449 *Author Interviews with various participants between August and October 2009. See Appendix 1.1.*
450 *Author Interview with a Deputy Director of Public Prosecution, October 2009*
451 *Glenister v President of the Republic of South Africa and Others.*
452 *Author Interview with a Deputy Director of Public Prosecutions, October 2009*

Molelle, the Head of the Assets Forfeiture Unit in KwaZulu-Natal, about the impact that the disbandment of the DSO had on the work of the AFU.

> **Author***:* On a percentage basis, how much of your work came from the DSO?
>
> **Adv. Molelle**: A bulk of our high value cases came from the DSO. In terms of values we got high value cases from the DSO. In terms of volumes, of course, we had a lot of volume but relatively small value cases from the police. Ja, so it was really that balance that we were dealing with.
>
> **Author**: So in the meantime, you just have to rely on your present workload as far as the high value cases are concerned?
>
> **Adv. Molelle**: Well at the moment, we still have cases that we carry on from the DSO that we will be carrying forward and all that. We do have some cases from the organised crime unit (of the SAPS) that are keeping us relatively busy. But of course there is that sort of a break from the influx of high value cases[453].

The disbandment of the DSO did not only affect the cases but also investigative powers of the AFU which were repealed under section 18 and 19 of the NPA Act of 1998[454]. AFU investigators were appointed under the same provisions as the DSO investigators. These powers were repealed in the process of disbanding the DSO[455]. The AFU now largely depends on the seconded police officers who now perform the investigative functions to support AFU work[456].

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[453] *Author Interview with Adv. Knox Molelle, the Head of AFU in Kwazulu-Natal, September 2009*.
[454] *Ibid.*
[455] *Ibid. Author Interview with Adv. Willie Hofmeyr, National Head of AFU and Deputy National Director of public Prosecutions, October 2009.*
[456] *Ibid.*

South Africa's Intelligence Services

Both the National Intelligence Agency and the South African Secret Service are listed as law enforcement agencies in terms of FICA. They are entitled to receive reports from the FIC, especially those that relate to both internal and external national security threats, including terrorism and crime. It is however not clear what these agencies do with such referrals. They also appear to receive a very minimum number of such reports (See Chapter 7 for the number of reports referred to NIA and SASS by the FIC between 2003 and 2008).

Foreign Financial Intelligence Units

South Africa became a member of the Egmont Group of Financial Intelligence Units in 2003. This Group was founded in 1995 and is a non-statutory transnational network of FIUs from about 120 countries. One of its objectives is to encourage international cooperation and enable FIUs to share financial intelligence on cross-border cases. Section 3 (a) of FICA provides that the objectives of establishing the FIC in South Africa is "to exchange information with bodies with similar objectives in other countries regarding money laundering activities, the financing of terrorist and related activities and other similar activities". The FIC is therefore entitled by law to share information it collects with FIUs of other countries. The exchange of this information is, according to the Egmont Group, 'reciprocal' meaning that no court orders are required in order for one FIU to share information/intelligence with another.

Section 40 of FICA provides that no person is entitled to information held by the FIC except the designated law enforcement agencies of South Africa, as discussed above, and

> 'an entity outside the Republic performing similar functions to those of the Centre, or an investigating authority outside the Republic which may, at the initiative of the Centre or on written request, obtain information which the Centre reasonably

> believes is relevant to the identification of the proceeds of unlawful activities or the combating of money laundering or financing of terrorist and related activities or similar offences in the country in which that entity is established'[457]

This formulation by FICA ensures that the FIC shares intelligence with other outside FIUs without any requirement of a court order or subpoena. There are however some 'safeguards' in FICA for this information sharing. Intelligence can only be shared with a FIU of another country if there is a 'written agreement' between the FIC and such an FIU[458]. This written agreement should be approved in writing by the Minister of Finance[459] and does not permit the FIC to "provide any category of information to the entity in respect of which the agreement is concluded which that entity is not permitted to provide to the Centre". In its last report (2009/10) the FIC reported that it contributed to 83 international investigations by responding to information requests from foreign FIUs.

Conclusion

This chapter sought to map out the legal, regulatory and institutional architecture of South Africa for dealing with organized crime through a central focus of attacking the proceeds of crime. Although not exhaustive, it started by discussing South Africa's organised crime phenomenon and by dispelling some myths on the early literature on organised crime in South Africa. It then discussed the provisions of POCA, FICA and the Terrorism Act of 2004. We noted that there is no jurisprudence in respect of the latter two laws and a growing body of case law under POCA. POCA's interpretations by the courts confirm our theorized situational crime prevention and risk management approaches (see Chapter 2) of the AML regime in the combating of crime. We also noted a somewhat disturbing trend of over-interpreting the provisions of POCA by the authorities

[457] See FICA, Section 40 (1) (b).
[458] *Ibid.* Section 40 (4).
[459] *Ibid.* Section 40 (5) (a).

and the courts such as extending organized crime legislation to traffic violations (as in *NDPP v* Van Staden) and extending it to regulate private individuals to play a 'stewardship' role which may potentially get them into trouble[460]. We also argued that this stewardship role is not clearly defined in law, as discussed in the *R O Cook Properties* case[461]. The purpose of this chapter was to lay a foundation for a discussion and analysis that follows in the next chapters. While this chapter was largely descriptive and sought to map out the legal, regulatory and institutional framework of South Africa, the following chapters start to test our hypotheses on the emergence of the regime and whether or not it is achieving its alleged goals of detecting and combating crime; thus protecting the integrity/soundness of financial institutions and global financial system. The next chapter examines why and how the regime emerged at a global level and got incorporated into developing countries and South Africa, in particular.

[460] See discussion of these cases in Appendix 4.2; *National Director of Public Prosecutions v 37 Gillespie Street Durban; National Director of Public Prosecutions v R O Cook Properties* and*; National Director of Public Prosecutions v Seevnarayan* .
[461] *Ibid.*

Chapter 5

The global emergence and incorporation of the FATF standards in South Africa: voluntary 'policy learning' or coercive 'policy transfer'?

Introduction

In seeking to solve their internal problems of various kinds, countries often learn from others how they have dealt with old and emerging problems[462]. In this process of learning they either 'copy', 'emulate', 'synthesise', or get 'inspired' to develop their own domestic solutions[463]. These solutions normally come in the form of policy, which is then translated into laws and regulations. These then culminate into institutions, practices and programmes that enable or facilitate implementation and enforcement. This learning, which a growing literature on public policy, political sciences and law variously refers to, has gained considerable attention and study by scholars over the last three decades. It seeks to explain how and why policy, institutions and practices get 'transferred' or 'diffused' to other jurisdictions. Is it perhaps as a result of rational policy making or as a result of other forces, including coercion? In doing this there has also been a focussed attention on examining the role played by various actors, both state and non-state, in the transfer of policy and institutional models developed elsewhere.

In this chapter we draw on this burgeoning literature to explain how (deliberative processes) and why (structural and ideational factors) the global AML regime has, over the past three decades, gained so much convergence in developing countries, looking particularly at South Africa. In drawing on this literature, we use interviews and archival data collected in South Africa

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[462] Rose, R. 1991. What is lesson drawing? *Journal of Public Policy*, Vol. 11, No.1, pp.3-30.
[463] See *Ibid.* See also Dolowitz, D. & Marsh, D. 1996. Who learns what from whom? A review of the policy transfer literature. *Political Studies*, Vol. 44, No. 2, pp.361-385.

to examine and explain how and why the global AML standards of the FATF have become a central feature in tackling organised crime.

We have argued, in the previous chapters, that the AML/CTF regime has emerged, in the last three decades or so, as the central strategy in the fight against organized crime, terrorism, money laundering and other similar high profile crimes. There appears to have been a shift from a narrow focus of traditional law enforcement methods such as imprisonment. The central focus lately has extended into enquiring into the financial benefits that sophisticated criminals derive from their illegal activities. This has been marked by asset confiscation and forfeiture laws and the wide-scale regulation of private businesses to report 'suspicious' and 'threshold' customer transactions to the so-called financial intelligence units (FIUs). All these new measures have been very transformational and profound, leading to a proliferation of many new institutions at both national and global levels, advocating and spearheading these new strategies.

It is reported that there are now more than 116 FIUs and over 170 countries and territories are claimed to be observing or implementing the FATF standards against money laundering and terrorist financing. The FIUs collect or receive and analyse financial intelligence, mainly from the transaction reports made by various regulated businesses. The primary goal of this has been, we are told, to detect and prevent money laundering and terrorist financing. There has also been an emergence of Asset Forfeiture Units/Agencies whose role in many countries has been to identify, confiscate and seize suspected or known proceeds of crime. These novel institutions within the criminal justice family have been complemented by a wide scale regulation of private businesses to perform various roles aimed at detecting or combating crime. All these efforts combined have taken law enforcement to a new level when it comes to fighting sophisticated 'profit-driven' criminals and their activities.

On top of this, many countries have developed specialised law enforcement agencies of many forms; some operating as special units or divisions within the police, prosecuting authorities and treasury departments. The focus of these specialised investigative units (many of them modelled on the ‘elitism’ of the US’s FBI, such as SOCA in the UK and the now defunct DSO in South Africa) has been on the high end of the market of criminal activity. Some of their crime-fighting initiatives involve proactive targeting of known criminals and the ‘disruption’ of organized crime syndicates.

The justifications for the strategy of regulating private businesses from particularly the FATF[464] and the Basel Committee on Banking Supervision[465] have been that business regulation, particularly of financial institutions, is not only vital for the combating of money laundering and its predicate crimes, but also crucial in maintaining a sound and stable global financial system. The reasoning is that the mere usage of financial institutions for criminal ends (i.e. money laundering) compromises their integrity and the confidence that legitimate users may expect of them[466]. This loss of confidence and integrity, it is argued, may have deleterious effects on these regulated institutions and may ultimately lead to their collapse[467].

In this chapter, we examine why and how South Africa adopted the AML/CTF standards of the FATF. Regarding the ‘why’, we focus mostly on the broader political and economic factors which caused South Africa to adopt its AML/CTF regime in the manner and form that it did. In respect to the ‘how’, we examine the deliberative processes followed in incorporating the regime, with a particular emphasis on the players that shaped South Africa’s AML regime. It is important to stress the importance of looking at these why and how questions. This is because of the manner in which the regime developed at a global level and spread throughout the world. This raises fundamental questions about the legitimacy of the FATF regime and its incorporation in developing countries, which is discussed in more depth in Chapter 8.

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[464] See FATF. 1991. *Annual Report FATF 1990-1991*, Paris, 13 May 1991, http://www.fatf-gafi.org/dataoecd/20/18/33643115.pdf accessed February 2008.
[465] See BCBS. 2001. *Customer due diligence for banks.* Working Group on Cross-Border Banking: Bank for International Settlements, Basel. http://www.bis.org/publ/bcbs77.pdf accessed October 2008.
[466] *Ibid.*
[467] *Ibid.*

Many scholars have argued that the diffusion of the regime to developing countries was irrational and illegitimate as it involved a number of coercive strategies by the powerful G7 countries who formed the FATF in 1989[468]. On top of that, developing countries were systemically excluded in the deliberative processes of the FATF, while at the same time expected to adopt and implement its standards under the intrusive scrutiny of the FATF and its principals[469]. Looking at South Africa, this chapter seeks to determine whether the country's incorporation of the regime was coerced or voluntary. In other words, was there any external political and/or economic pressure exerted on South Africa to adopt the FATF standards? Were there any political and economic consequences for not adopting this framework? If so, what were those potential consequences and impacts? If there was pressure, we shall conclude that South Africa's adoption of the regime was coercive. It is also important to examine the sources of such pressure and how these manifested themselves in the whole process of South Africa's incorporation of the global FATF regime. Whose interests, would such political and economic pressure serve?

While we use regulation theory, we fuse it with 'policy transfer analysis' to explain why and how South Africa adopted the regime in the manner that it did. There are two strands of competing hypotheses which are based on regulation theory. These are what Morgan and Yeung have conveniently classified as 'public interest' and 'private interest' theories of regulation[470]. To explain the incorporation of the regime in South Africa, these two opposing strands of theory offer competing hypotheses. On the one hand, the public interest theory leads to a hypothesis that the South African government incorporated the global AML regime in order to solve its growing organized crime problems and to modernize its outdated laws and institutions, in the context of its transition from apartheid to democracy and its economic liberalization which brought about, as argued by some, increased organized crime opportunities or risks in a globalised world.

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[468] See *Ibid.*

[469] *Ibid.*

[470] See Morgan, B., & Yeung, K. (2007). *An introduction to law and regulation: texts and materials*. New York: Cambridge University Press. See also Chapter 2 above for a discussion on the theories of regulation.

On the other hand, the private interest theory suggests a hypothesis that South Africa's incorporation of the FATF regime emerged to serve various particular interests-- notably those of the 'great powers' who championed the regime's establishment and diffusion to developing countries. According to this hypothesis there may well be valid claims that these interests were not necessarily aimed at combating organised crime and money laundering. If the regulatory regime also served South Africa in combating crime and maintaining the integrity of its financial institutions (which are the explicit goals of the FATF AML/CTF regime), such a convergence of interests was, according to this line of argument, just mere coincidence. The above two competing hypothesis help us address both the why and the how explanations of the emergence and ultimate incorporation of the AML regime. In order to test the public interest hypothesis, this chapter will explore whether South Africa's incorporation of the AML/CTF regime was voluntary and was done without any undue political and economic pressure/influence by the FATF and/or those behind it and its standards. On the other hand, to test the private interest hypothesis, we will consider the extent to which South Africa adopted the regime under pressure from the FATF and/or those representing it and/or those who stood to benefit from the diffusion of its regulatory standards and outcomes.

Five key questions emerge from this: 1. Who are the agents of the AML/CTF policy transfer? 2. What exactly was transferred, from where and why? 3. When did this transfer occur? 4. Why did South Africa adopt the AML/CTF policies in the manner that it did? 5. How did the transfer take place (in other words, was it coercive or voluntary)? We do not answer these questions sequentially as their explanations overlap. However before we set out to answer them, in the first part we start by examining the concept of 'policy transfer', how it developed and the sort of the empirical work conducted using 'policy transfer analysis' thus far. It appears that the bulk of empirical literature and theorising has been largely focussed on developed countries learning from each other. We argue that while both theoretical and empirical work on 'policy transfer' has focussed on developed countries, it has missed some rich theoretical and empirical contributions on developing countries.

In the second part we examine the practice of policy transfer in relation to developing countries. In this regard, we argue that while developing countries normally get ‘spoon-fed’ with models developed elsewhere, particularly by donor countries of the West and their international financial institutions (e.g. the Bretton Woods Institutions), there are instances where ‘policy transfer’ occurs voluntarily without any external and undue coercive pressure. We do this by borrowing from the thin empirical literature on policy learning and transfer in developing countries. The third part examines the practice of policy learning by South African authorities post-1994. Finally the fourth part addresses the core questions mentioned earlier.

What is Policy Transfer?

The contemporary study of ‘policy transfer’ is traced from ‘policy diffusion’ studies within the political science literature and spans from the late 1960s and early 1970s[471]. In the literature on political science, international studies and law, the concept of ‘policy transfer’ has been referred to using various and sometimes overlapping terminologies such as ‘lesson-drawing’, ‘policy convergence’, ‘policy diffusion’, ‘policy transfer’, ‘policy harmonisation’ and ‘legal transplants’. This varying terminology and the focus of studies in these fields refers to a

> “process by which knowledge about policies, administrative arrangements, institutions and ideas in one political system (past or present) is used in the development of policies, arrangements, institutions and ideas in another political system”[472].

This means that one country borrows from ideas, institutions, experiences and processes of other jurisdiction(s). This definition of policy transfer seems not broad enough to capture the

[471] See *Ibid.*
[472] Dolowitz, D. and Marsh, D. 2000. ‘Learning from abroad: the role of policy transfer in contemporary policy making’, *Governance: An International Journal of Policy and Administration*, Vol.13 (1), p.5.

overarching and multi-level pathways of policy transfer in an increasingly globalised world. Evans offers an alternative and broader definition. According to him policy transfer is a

> "…process or set of processes in which knowledge about institutions, policies or delivery systems at one sector or level of governance is used in the development of institutions, policies or delivery systems at another sector or level of governance"[473]

This broader definition appreciates the role played by various parties including state and non-state actors, the multiplicity of processes through which policies could be borrowed or transferred and the multi-level nature of governance in the 21st century.

A number of scholars from various fields of social sciences have developed policy transfer analysis both theoretically and empirically. Some of the theoretical literature includes work by Rose[474] on 'lesson-drawing', Dolowitz and Marsh[475], Mossberger and Woolman[476], Evans and Davis[477], and Evans[478] on 'policy transfer', Bennett[479] on 'policy convergence', Walker[480], Gray[481], Savage[482], and Berry and Berry[483] on 'policy diffusion', Newmark[484] on 'policy transfer'

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[473] Evans, M. 2009. 'Policy transfer in critical perspective.' *Policy Studies*, Vol. 30 (3), pp.243-268, p. 243.
[474] Rose, R. 1991. 'What is lesson drawing?' *Journal of Public Policy*, Vol. 11(1), pp.3-30.
[475] Dolowitz, D. and Marsh, D. 2000. 'Learning from abroad: the role of policy transfer in contemporary policy making', *Governance: An International Journal of Policy and Administration*, Vol.13 (1), p.5.
[476] Mossberger, K. & Wolman, H. (2003). Policy Transfer as a Form of Prospective Policy Evaluation. *Public Administration Review,* Vol. 63 (4), pp.428-440.
[477] Evans, M. & Davis, J. 1999. 'Understanding policy transfer: a multi-level, multi-disciplinary perspective.' *Public Administration*, Vol. 77 (2), pp.361-385.
[478] Evans, M. 2009. 'Policy transfer in critical perspective.' *Policy Studies*, Vol. 30 (3), pp.243-268.
[479] Bennett, C.J. 1991. What is lesson policy convergence and what causes it? *British Journal of Political Science*, Vol. 21, pp.215-233.
[480] Walker, J.L. 1969. 'The diffusion of innovations among American states.' *American Political Science Review*, Vol. 63, pp.880-899.
[481] Gray, V. 1973. Innovation in the States: a diffusion study. *The American Science Review*, Vol. 67 (4), pp.1174-1185.
[482] Savage, Robert L. 1985. Diffusion research traditions and the spread of policy innovations in a federal system. *Publius: The Journal of Federalism.* Vol. 15(4), pp.1-28
[483] Berry, F. S. & Berry W.D. 1992. Tax Innovation in the States: Capitalizing on Political Opportunity. *American Journal of Political Science,* Vol. 36(3), pp.715–742.
[484] Newmark, A.J. 2002. An integrated approach to policy transfer and diffusion, *The Review Policy Research*, Summer, Vol. 19 (2).

and 'policy diffusion', Page[485] on 'policy transfer' and 'lesson-drawing' and Oliver[486] (2009) on the 'transfer process', Hoberg[487] on 'emulation', Waltman[488] on 'copying', Studlar and Layton-Henry[489] on 'policy borrowing'.

There has also been a critique by James and Lodge[490] on the limits of some of the theoretical analytical models developed by some of these scholars, particularly on 'policy transfer' and 'lesson drawing'. There has also been substantial empirical work conducted on various forms of policy. Tim Newburn's study[491] focussed on the 'transfer', from US to Britain, of crime control policies. Bennett's[492] cross-national study focused on the transfer of instruments of bureaucratic accountability such as the institution of ombudsperson, access to information legislation and data protection laws. Dolowitz's[493] work dealt with the transfer between Britain and the US, during the Thatcher-Reagan administrations, of employment, welfare and child support policies. Majone[494] wrote on the impact of US regulators on European anti-cartel legislation and Eccleston[495] on the global diffusion of Value Added Tax policies in the past couple of decades. Instead of examining particular policy areas, other work has looked into the role of various players

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485 Page, E.C. 2000. *Future governance and the literature on policy transfer and lesson drawing*. ESRC Future Governance Programme: Workshop on Policy Transfer, 28 January.

486 Oliver, M. L. 2009. The transfer process: implications for evaluation. *New Directions For Evaluation: Wiley Periodicals*, Vol. 2009 (124), pp.61-73.

487 Hoberg, G. 1991. Sleeping with an elephant: the American influence on Canadian environmental regulation. *Journal of Public Policy*, Vol.11, pp.107-132.

488 Waltman, J.L. 1980. *Copying other nations' policies: two American case studies*. Schenkman Pub. Co.

489 Studlar, D. & Layton-Henry, Z. 1991. Ethnic minority groups, agenda-setting and policy borrowing in Britain. in *Minority group influence: agenda setting, formulation and public policy*, ed.P.D. McClain. New York: Greenwood Press.

490 James, O. & Lodge, M. 2003. The limitations of 'policy transfer' and 'lesson drawing' for public policy research. *Political Studies Review*, 2003, pp.173-193.

491 See Newburn, T. 2002. Atlantic crossings: 'policy transfer' and crime control in the USA and Britain. *Punishment and Society*, Vol. 4, pp.165-194.

492 Bennett, C.J. 1997. Understanding ripple effects: the cross-national adoption of policy instruments for bureaucratic accountability. *Governance: An International Journal of Policy and Administration*, Vol. 10 (3), pp.213-233.

493 Dolowitz, D. 1997. British employment policy in the 1980s: learning from the American experience. *Governance*, Vol. 10, pp.23-42. See also Dolowitz, D.1998.*Learning from America: policy transfer and the development of the British Workfare State*. Brighton: Sussex Academic Press.

494 Majone, G. 1991. Cross-national sources of regulatory policy making in Europe and the United States. Journal of Public Policy, Vol. 12, pp.331-354.

495 Eccleston, R. 2006. *Whose idea was it anyway? The dynamics of international policy transfer and the case of consumption tax reform*. Refereed paper presented to the Australasia Political Studies Association Conference, University of Newcastle, 25-27 September 2006.

in the process of transfer. This includes the work of Stone[496] on the role of 'think tanks' and epistemic communities and Ladi's[497] on policy research institutes.

Policy transfer can either be coercive or voluntary[498]. A voluntary transfer takes place when, for instance, a government seeks to bring about change and learns from another country[499]. This may include vertical[500], horizontal[501] and multi-level[502] transfers. The empirical literature on voluntary transfer cited above focussed on developed countries. There is however a very thin body of empirical literature on developing countries (see below). This does not suggest that developed countries are immune from coercive forms of transfer[503]. However, many scholars are quick to assure and point out that coercive policy transfer is not the norm in developed countries[504]. This seems to suggest that developed countries still generally enjoy some measure of sovereignty and autonomy in policymaking as compared to developing countries. In other words, developed countries learn voluntarily from each other while developing countries generally incorporate models which largely do not fit their socio-economic needs and, more often, under duress from donor countries and international financial institutions that are largely controlled by developed countries[505]. However there appears to be a thin line between coercive and voluntary transfer. For

[496] Stone, D. 2001. Think tanks, global lesson drawing and networking social policy ideas. *Global Social Policy*, Vol. 1, pp.338-360.
[497] Ladi, S. 2005. *Globalisation, policy transfer and policy research institutes*. Cheltenham: Edward Elgar.
[498] Evans, M. 2009. 'Policy transfer in critical perspective.' *Policy Studies*, Vol. 30 (3), pp.243-268, p. 245.
[499] *Ibid.*
[500] By vertical is meant organizations without a similar status, in socio-economic terms. An example of this would be a municipal authority learning/borrowing from a federal or national authority or vice versa, within the same jurisdiction.
[501] By horizontal transfer this paper refers to organizations with a similar status who learn or borrow from each other; once-off or continuously. It could be national government departments within the same jurisdiction or from another similar country, in socio-economic terms.
[502] Multi-level policy transfer is rather complex. It infuses both the vertical and horizontal lines of transfer. For instance, a local authority in a developing country drawing lessons or borrowing from another local authority of a foreign developed country. This relationship may seem horizontal, but it is indeed both horizontal and vertical in that both the actors involved are local authorities. However, if we consider the socio-economic environments in which they are located, another dynamic of verticality sets in in that horizontal relationship.
[503] Evans, M. 2009. 'Policy transfer in critical perspective.' *Policy Studies*, Vol. 30 (3), pp.243-268.
[504] See, for instance, *Ibid.* and Dolowitz, D. & Marsh, D. 1996. 'Who learns what from whom?: A review of the policy transfer literature'. *Political Studies*, Vol. 44, No. 2, pp.361-385.
[505] Alou, M.T. 2009. Between autonomy and dependence: policy transfer dynamics in Sub-Saharan Africa. *Conference Paper: policy transfer or policy learning: interactions between international and national skills development approaches for policy making*, Geneva, 25-26 June 2009.

instance, ‘formal to state’ (see below) transfers could be some form of a coercive transfer, although these are normally “negotiated” transfers[506]. Many authors observe that the EU directives to EU member states are a form of coercive (formal to state) transfer, although they are negotiated.

Evans[507] classifies coercive policy transfer as either ‘negotiated’/’indirect’ or ‘direct’. A ‘negotiated/indirect transfer’ involves a “process in which governments are compelled…to introduce policy change…”[508] Examples of negotiated transfers would be such regimes as the EC system, which binds member states to abide by its Directives as much as the UN does to signatories of its conventions or treaties. Other common examples used in the literature are the structural adjustment programs (SAPs) of the IMF and World Bank. These are prescribed for mainly developing countries which many have been, since the early 1980s, regular recipients of conditional funds or loans from the World Bank and IMF[509]. Such loans or aid packages normally come with what is referred to as ‘conditionalities’ that recipient countries have no choice but to accept when desperate for funding. Some of these ‘conditionalities’ have involved ‘wholesale privatisation of state assets’[510]. The latest ‘conditionality’ is directly related to this study. This requires loan and aid recipient countries to develop domestic AML/CTF measures[511]. ‘Direct coercive transfer’ refers to situations where a government is forced by another or other governments and/or actors to introduce constitutional, social and political changes against its will[512]. An example of this could be the pressure which the US is exerting on Iran, for instance, to stop its nuclear enrichment programme.

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[506] See Evans, M. 2009. ‘Policy transfer in critical perspective.’ *Policy Studies*, Vol. 30 (3), pp.243-268.
[507] *Ibid.* P.245.
[508] *Ibid.*
[509] *Ibid.*, Massey, A. 2009. Policy mimesis in the context of global governance. *Policy Studies*, Vol. 30 (3), pp. 383-395. De Jong, M. & Edelenbos, J. 2007. An insider’s look into policy transfer in transnational expert networks. *European Planning Studies*, Vol. 15 (5) pp.687-706.
[510] See Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York, Oxford: Oxford University Press for more on IMF and World Bank conditionalities.
[511] See *Ibid.*
[512] Evans, M. 2009. ‘Policy transfer in critical perspective.’ *Policy Studies*, Vol. 30 (3), pp.243-268, p.245.

Policy transfer literature refers to various forms/types of transfer. These include copying, emulation, hybridisation, synthesis and inspiration[513]. Copying is when a policy, programme or institution is adopted without modification[514]. This is generally regarded as a rare phenomenon. Emulation involves situations where a governmental organisation, for example, "accepts that a policy, programme or institution overseas provides the best standard for designing a policy, programme or institution at home"[515]. Such an organisation would therefore use a foreign programme as a benchmark in designing its own. Hybridisation happens where a governmental organisation, for an example, combines elements of programmes found in two settings to develop a policy that is culturally sensitive to the needs of the recipient[516]. Synthesis is like hybridisation, but involves multiple settings rather than only two[517]. Inspiration takes place where an idea inspires fresh thinking about a policy problem and helps to facilitate policy change[518].

The next question is what the drivers of policy transfer are. What inspires this hybridisation, copying, emulation or inspiration that the literature identifies as processes of policy transfer? According to the literature, there are a number of structural forces that shape these processes. These include the increased phenomenon of globalisation. It is argued that there are patterns of increased internationalisation that pose significant constraints on the ability of most countries to craft independent and autonomous economic strategies[519]. This has led to the emergence of global multi-lateral governance initiatives. The concept of governance here is used to denote the role of both 'state' and 'non-state' activity at a global level. This arena of governance is replete with a variety of structures that emanate from cooperative legally binding treaties and

[513] See *Ibid.*
[514] *Ibid.*
[515] *Ibid.* p. 246.
[516] *Ibid.*
[517] *Ibid.*
[518] *Ibid.*
[519] See *Ibid.* p. 255. See also Massey, A. 2009. Policy mimesis in the context of global governance. *Policy Studies*, Vol. 30 (3), pp. 383-395. Alou, M.T. 2009. Between autonomy and dependence: policy transfer dynamics in Sub-Saharan Africa. *Conference Paper: policy transfer or policy learning: interactions between international and national skills development approaches for policy making*, Geneva, 25-26 June 2009. Stone, D. 2001. Think tanks, global lesson drawing and networking social policy ideas. *Global Social Policy*, Vol. 1, pp.338-360.

conventions of states, to more ‘informal’ non-legal activity of soft-law regimes that continue to emerge and to colour the global governance landscape, sometimes with similar impacts and implications to that of hard law regimes. Another driver of policy transfer is identified as ‘state centred forces’[520]. These are, according to Evans, rooted in transformational theories that see policy transfer as a key strategy for transforming the state[521]. The third driver is seen as the policy transfer networks such as ‘think tanks’[522] or policy research institutes[523] that have recently expanded their operations from nation-states to global and trans-national domains[524]. These, according to Stone, involve collaborative decision structures comprised of state and non-state actors that are set up with deliberate intentions of engineering policy change[525]. Evans argues that these think tanks or research institutes are carriers of particular belief systems and use their membership of formal and informal international policy networks to disseminate international policy agendas[526]. Evans concludes that

> “The content of policy transfer is often informed by notions of best practice disseminated by international organisations, knowledge institutions and think tanks in the international domain, suggesting that ideological considerations play a key role in informing the content of policy transfers. These agents of transfer play a key role in facilitating policy-oriented learning through imparting technical advice…where indigenous state actors lack expertise”[527].

[520] Evans, M. 2009. ‘Policy transfer in critical perspective.’ *Policy Studies*, Vol. 30 (3), pp.243-268, p.258.
[521] See *Ibid.* for more on this.
[522] See Stone, D. 2001. Think tanks, global lesson drawing and networking social policy ideas. *Global Social Policy*, Vol. 1, pp.338-360.
[523] Ladi, S. 2005. *Globalisation, policy transfer and policy research institutes*. Cheltenham: Edward Elgar.
[524] Stone, D. 2001. Think tanks, global lesson drawing and networking social policy ideas. *Global Social Policy*, Vol. 1, pp.338-360.
[525] *Ibid.*
[526] Evans, M. 2009. ‘Policy transfer in critical perspective.’ *Policy Studies*, Vol. 30 (3), pp.243-268, p.260. See also *Ibid.*
[527] Evans, M. 2009. Policy transfer in critical perspective. *Policy Studies*, Vol. 30 (3), pp.243-268, p.260.

Evans[528] points out that while all these organisations offer great opportunities for solving problems of common concern, the 'processes that emanate from them can also act as sites of struggle for competing conceptions'. Up until now, it appears that countries do borrow policies from each other in order to enhance their governing strategies at home or to solve new problems, or perhaps even old ones. There is however a dearth of empirical literature on policy transfer in developing countries; either learning from each other or from developed countries.

Developing countries and policy transfer

Many developing countries, especially in sub-Saharan Africa, South Africa included, have just emerged from a recent and long history of colonial domination and imperialism. The sub-Saharan region of Africa is the poorest in the world and it is a region where democratic governance after colonial independence has been largely unbalanced and uncertain. It is a region marred by many armed civil conflicts and bloody struggles for power, dictatorial and military regimes, accompanied by underdevelopment. There have been a number of theories and explanations as to why the Sub-Saharan Africa region lacks development and progress since colonial independence. Socio-economic indicators have largely painted a gloomy picture. The most salient prerogative of constitutionally elected and representative democratic parliaments is to make policies that would better the lives of their citizens. After all, in a democracy, it is these electorates that give governments authority and legitimacy to govern. In most post-colonial societies struggles were waged for liberation, independence from foreign domination, sovereignty, universal suffrage, democratic governance, self-determination and similar kinds of values, principles and rights.

Such struggles were undertaken by those who believed that after liberation those who were elected would bring about not only political change, but also economic and social change. A salient feature of this economic and social change is that it should occur through the governance

[528] *Ibid.* p.257.

mechanisms which are founded on policy. The governing elite, might, therefore, be expected to adopt policies, enact laws and institutions and implement programmes that would bring about this change of enhancing people's livelihoods. However, soon after national liberation, many of these societies, particularly in Sub-Saharan Africa have been faced with a stark reality. It is that their aspirations may be just an illusion. While many promises were made about development, these often end up as pipe dreams.

There appears to be a gap in the study of the spread of policy to developing countries after independence. The gap can be attributed to the fact that policy transfer analysis has almost exclusively studied Western countries learning from each other. Therefore policy transfer analysis has been largely developed to study voluntary schemes of policy transfer, or what Rose[529] refers to as 'lesson drawing', between developed countries. Alou explains the history of Sub-Saharan Africa and development policy admirably in his paper *Policy Transfer or Policy Learning: Interactions between International and National Skills Development Approaches for Policy Making*[530]. He explains that post-colonial Sub-Saharan African governments, in the 1960-1970s, had state-centred development policies[531]. The focus of such policies in these newly independent states was on building the state apparatus that actively drove economic development. However this was not much of a success, leading them to question the role of the state in the late seventies, after the international oil crisis[532].

The focus was redirected, under the Washington Consensus, to a neo-liberal, market-led development, with states ideologically discouraged from playing too active a role in development. Developing countries during this period were forced into adopting structural adjustment programmes. Development aid and loans from the IMF and the World Bank were conditional upon

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[529] Rose, R. 1991. 'What is lesson drawing?' *Journal of Public Policy*, Vol. 11(1), pp.3-30.
[530] Alou, M.T. 2009. Between autonomy and dependence: policy transfer dynamics in Sub-Saharan Africa. *Conference Paper: policy transfer or policy learning: interactions between international and national skills development approaches for policy making*, Geneva, 25-26 June 2009.
[531] *Ibid.*
[532] *Ibid.*

such adoption.[533]. This has made policy making, according to Alou, boring and predictable as policymakers just have to implement policy as directed by donor countries and the IFIs based on the conditions set for them[534]. There is a thin but growing body of empirical literature that has studied policy transfer in developing countries. This literature offers some valuable theoretical contribution into policy transfer analysis. Below we briefly look at the work of Barcham[535], Siddiquee[536], and Gonzales[537].

Barcham studied the institutional transfer of the Ombudsperson's Office between Papua New Guinea and Vanuatu, both small developing island countries in the Pacific region. What appears in his study is that while the Ombudsman Commission of Papua New Guinea might have borrowed from a developed country, the transfer of such an institution to Vanuatu from Papua New Guinea (South-South transfer) seems to provide solutions to some major problems which have been identified in the North-South policy transfers. Two major problems, according to Barcham, are associated with North-South policy transfer. First is the problem of capacity[538]. The capacity issue lies in the disparity between developed and developing countries. This is because "institutions created in developed countries are often designed, implicitly or explicitly, with certain levels of capacity in mind" and when they are transferred to developing countries with "lower levels of state capacity they often do not work"[539]

The second problem of North-South transfer is the problem of cultural misfit[540]. This means that institutions developed for different cultural contexts are adopted in a totally different

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533 *Ibid.*
534 *Ibid.*
535 Barcham, M. 2003. South-South policy transfer: the case of the Vanuatu Ombudsman's Office, *Pacific Economic Bulletin*, Vol. 18 (2), pp. 108-116.
536 Siddiquee, N.A. 2007. Public service innovations, policy transfer and governance in the Asia-Pacific region; The Malaysian experience. *JOAAG*, Vol. 2 (1), pp. 81-91.
537 Gonzales, E.T. 2007. Policy transfer in the Philippines: can it pass the localization test. *JOAAG*, Vol. 2 (1), pp. 1-10.
538 Barcham, M. 2003. South-South policy transfer: the case of the Vanuatu Ombudsman's Office, *Pacific Economic Bulletin*, Vol. 18 (2), pp. 108-116, p. 108.
539 Ibid. p.109.
540 *Ibid.* See also Minogue, M. 2002. *Public Management and Regulatory Governance: problems of*

one; leading to them getting rejected[541]. Barcham recognises that many institutions in developing countries are often a result of a North-South transfer. Where these have been successful, Barcham suggests, other similar countries may not need to reinvent the wheel of North-South transfer, but emulate the second hand experience from a similar country, thus making it a South-South transfer[542]. Another important contribution comes from the work of Gonzales[543]. Gonzales's work dealt with the voluntary transfer of budgeting processes by the Phillipines from Australia. Gonzales's study highlights both the problems identified by Barcham, concerning North-South policy transfer. He offers solutions as well, which are somewhat similar to Barcham's. First, Gonzales notes that local conditions generate either acceptance or resistance to imported policies or practices, whether such policies have been modified or not[544]. He therefore argues that imported lessons should be learned in ways that reinforce more than they transform local practices[545].

This could be achieved, according to Gonzales, through capacitating local policy makers to analyse their own situation and tailor policy to fit the domestic context, rather than simply applying standard models[546]. He argues that well-capacitated policy makers would be able to know what questions to ask in establishing a clear understanding of how the policies they intend to import work in their country of origin[547]. They would also be able to understand how such policies were fashioned by 'social, economic, political and institutional settings, and how well they work in practice' in the exporting country[548]. Further, policy makers need to know 'the comparable aspects of the policy situation in their own country—a process of reflection and self-examination'[549].

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policy transfer to developing countries, Working Paper No. 32, Centre on Regulation and Competition, Manchester: University of Manchester.

541 See Barcham, M. 2003. South-South policy transfer: the case of the Vanuatu Ombudsman's Office, *Pacific Economic Bulletin*, Vol. 18 (2), pp. 108-116.

542 *Ibid.*

543 Gonzales, E.T. 2007. Policy transfer in the Philippines: can it pass the localization test. *JOAAG*, Vol. 2 (1), pp. 1-10.

544 *Ibid.* p. 2.

545 *Ibid.* p. 8.

546 *Ibid*.

547 *Ibid*.

548 *Ibid*.

549 *Ibid*.

Gonzales suggests an establishment of 'regional policy networks' that could help solve common problems between similar countries. These are networks of 'technical experts in similarly situated countries, who have distinctive but interdependent interests, and who are striving to solve similar problems'[550]. Lastly, he suggests that policy makers need to take a long-term perspective because it takes some time before foreign innovations are '"domesticated" as local institutions and policies shape their development'.

Secondly, he suggests that benchmarking should not be limited to highly developed countries, since 'best ideas and projects are now increasingly coming from smaller countries'[551]. Learning from smaller or similar countries would allow decision makers to shape the importation 'more than they will be shaped by it'[552]. This last point is similar to Barcham's where he suggests South-South forms of policy transfer. Siddiquee, looking at the Malaysian experience of the New Public Management, where the political leadership encouraged or pioneered the 'Look East Policy', suggests something along similar lines[553]. The 'Look East Policy' was an attempt to encourage Malaysia to change its 'traditional perspective' on Western countries as 'role models' and instead learn from other countries such as Japan and South Korea which had succeeded in achieving remarkable economic progress; high productivity, claims to strong ethical standards and management philosophy and practices[554].

It appears from the empirical work, cited above, of Barcham, Gonzalez and Siddiquee that they do not view North-South policy transfer as necessarily bad or something that needs to be abandoned. It is, however, something that should be undertaken with caution; to attempt to get around the problems identified in such kinds of transfer. Countries do often learn from each other. However since most of the empirical and theoretical literature has been biased towards North-

[550] *Ibid.*
[551] *Ibid.*
[552] *Ibid.*
[553] Siddiquee, N.A. 2007. Public service innovations, policy transfer and governance in the Asia-Pacific region; The Malaysian experience. *JOAAG,* Vol. 2 (1), pp. 81-91.
[554] *Ibid.* p.85.

North transfers, we hardly learn about the problems that North-South transfers bring about and solutions to unintended outcomes. North-South empirical work provides a welcome contribution to enriching the theoretical literature. The work referred to above, relating to developing countries, addresses voluntary policy transfer. From the case-studies of Barcham, Gonzales and Siddiquee, we get a sense that the importing countries wanted to deal with practical problems of improving governance in their localities. This dispels the impression created by some literature where developing countries are portrayed only as passive recipients of developed country models. Some of the policy changes they adopt have been thought through as much as some of them have been occasioned by structural and external coercive forces. If there is anything to be observed it is that developed countries themselves are more and more becoming subjects of coercive policy transfer.

While some scholars are quick to point out that coercive policy transfer is rare in developed countries[555], it seems that it is more and more becoming the norm. Although some transfers, such as the austerity measures being implemented by such countries such as Greece, Ireland and Spain in the wake of the global recession EU/IMF bailouts, are negotiated, they may be argued to be coercive in nature. These troubled countries appear to have no choice but to accept the bailouts/loans with the stringent and unpopular conditions attached to them. They have been damned to face the wrath of the masses when they implement these austerity measures as shown by the wave of protests against the introduction of such bailout conditions. They would also have been damned if they did not accept them as their economies were on the brink of collapse. We now turn to the third part of this chapter, where we examine the phenomenon of policy learning and transfer by South African authorities.

[555] See for instance Evans, M. 2009. 'Policy transfer in critical perspective.' *Policy Studies*, Vol. 30 (3), pp.243-268, p. 245, where he says coercive policy transfer is common in developing countries.

South Africa and policy transfer

South Africa gained its political freedom in 1994, after a 40 year internal rule by the apartheid government and several decades of British colonial rule. Modern forms of governance were obviously inherited from these regimes. When the new government came into power it inherited laws, institutions, civil service bureaucrats from the apartheid state and its homelands which had been created for various ethnic groups and in line with the racial and ethnic segregation laws of the British and the Afrikaners. After 1994, there was a drive to transform the whole state apparatus to try and conform to the new constitutional values and principles underpinned by democracy and the rule of law. This led to the consolidation of separate apartheid administrations into a unitary state with one central/national government, nine provincial governments and about 243 municipal councils[556]. This transformation also entailed the same process with the bureaucratic state apparatus, where eleven separate police forces, attorney-general's offices, education systems, health departments and so on, which had been divided along ethnic lines by the apartheid state, were consolidated into single departments at the national level and mostly with parallel functionalities at the provincial level and overlaps at the municipal level.

The democratic government of 1994 was a result of a negotiated settlement by mainly the liberation movements, prominently the African National Congress, and the apartheid government and its elite. The negotiations included what was referred to as the 'sunset clause', which guaranteed apartheid employees their jobs in the democratic dispensation. While a small percentage of civil servants of the apartheid state left state employment for a variety of reasons, many remained and some occupied very senior strategic jobs. There have been some defining political changes in South Africa. One such was the enactment of the transitional/interim Constitution of 1993, which came into force in April 1994, after the first democratic elections.

[556] See Schedule 4 and 5 of the *South African Constitution*, *Act 106 of 1996.*

The final constitution was deliberated upon by a democratically elected parliament. Under the transitional constitution, a Government of National Unity, led by the ANC and Nelson Mandela was established. This transitional arrangement accommodated opposition parties in the executive (Cabinet). A Constitutional Assembly (parliament) was established to draft, deliberate on and pass the final constitution. The *South African Constitution*, *Act 106 of 1996,* was passed in May 1996. This Constitution paved the way for the structure of government, its role, powers and institutions. Due to inequalities inherited from apartheid, one of the major tasks for the new democratic government was to come up with policies that would uplift the socio-economic standards of living for the previously marginalized majority. This had to be done while also encouraging economic growth[557]. South Africa's socio-economic policies are generally viewed by the ANC government to be explicitly designed to be more inclusive and to advance the interests of the so-called previously disadvantaged groups in society. To this end, South Africa has sought to drive policy change through its constitutionally established structures. While much policy has developed from within, it seems that there has been some measure of policy borrowing/learning from other democratic jurisdictions, particularly Western countries, and, to a lesser extent, from other developing countries in crafting the new policies of the post-apartheid state.

With political transition, the country got accepted back into the international community following the ending of UN-imposed apartheid sanctions. Democratic South Africa has then sought strategically to position itself as part of the global community in a variety of ways from sports (hosting the Rugby World Cup in 1995, Cricket World Cup in 2004 and the FIFA World Cup in 2010, among others), tourism, trade and involvement in formal and informal regional, international and global governance structures[558]. There are a number of seemingly obvious reasons for this strategic positioning. Key among them is that South Africa is an economic

[557] Colonial and apartheid policies were largely designed to exclude the majority of citizens, particularly the African majority and other minority, non-white groups.
[558] See The Presidency. 2003. *Towards a ten year review: synthesis report on implementation of government programmes.* Policy Coordination and Advisory Services: The Presidency, South Africa, October 2003. http://www.info.gov.za/otherdocs/2003/10year.pdf p. 1-144.

powerhouse of the generally impoverished Sub-Saharan Africa. The problematic issues of this region are well chronicled and among them is the fact that successive measures of socio-economic development and political stability have, for a variety of reasons, often floundered since the wave of independence from colonial rule swept across Africa from the late 1950s onwards.

South Africa's role in the region, post-apartheid, is noticeable. In trying to encourage good governance and democracy, former President Thabo Mbeki is credited for coming up with the New Partnership for Africa's Development (NEPAD) and in driving the process for the revival of the former Organisation of African Unity into the African Union[559]. South Africa has also played a vital role in resolving conflicts in the region, from the Democratic Republic of Congo and Sudan to Zimbabwe where it is still involved. South Africa has also managed to find its way, some argue— punching above its weight, into some key decision-making global forums such as the G20, G8+5 and BRICS, among others. It continues to seek membership in the OECD.

While many Sub-Saharan countries are deeply affected by debt and dependence on IMF and World Bank aid and loans, which impose on them structural adjustment requirements, South Africa has managed to avoid over-indebtedness and has not desperately sought rescue by these *de facto* policymakers for most of the Sub-Saharan Africa region. This was despite debt accumulated by the apartheid government, which had to be serviced by the new democratic government[560]. In the area of foreign policy, South Africa appears to have shown some measure of autonomy by not seeking to appease the hegemonic powers. This is partly borne out of the relationships that South Africa openly developed with countries that were not in the good books of the US such as Cuba, Iran, Palestine and Libya[561]. South Africa's development of these relationships in the early years under Nelson Mandela raised some concerns on the part of its Western allies.

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[559] See *Ibid.* See also Alden, C & Le Pere, G (2004) South Africa's Post-Apartheid Foreign Policy: From Reconciliation to Ambiguity? *Review of African Political Economy*, Vol.31, No 100, pp283-297.

[560] See Chapter 2 above.

[561] See The Presidency. 2003. *Towards a ten year review: synthesis report on implementation of government programmes*, Policy Coordination and Advisory Services: The Presidency, South Africa, October 2003. http://www.info.gov.za/otherdocs/2003/10year.pdf p. 1-144.

The ANC under Nelson Mandela emphasised autonomy and sovereignty of South Africa when it came to foreign policy and self-government. After all, it is hard to imagine how the ANC could sever ties and relationships that it had established with these countries during its liberation struggle and from whom it had received support. In 1999 when Mandela retired, the ANC under Thabo Mbeki continued to emphasise this autonomy and sovereignty. As the largest economy in sub-Saharan-Africa, it also has perceived its role as being one of representing the continental and regional interests, especially under Mbeki's African Renaissance, AU and NEPAD projects[562].

Under these circumstances, it would seem that South Africa enjoys some considerable measure of autonomy in its policy-making decisions and processes. Its policy content and adoption would be expected to be less externally directed as compared to some of the developing countries in the sub-Saharan Africa region whose budgets are *de facto* drawn up by the IFIs and donor countries. However, is that the case? This study cannot answer this question fully as it looks at one particular policy issue of the incorporation of the FATF standards. There have been only a few studies conducted in South Africa to examine these issues of policy transfer. The closest study was a policy transfer exercise itself, conducted by the Small Business Project (SBP)[563] consortium and the Centre for Regulation and Competition at the University of Manchester[564].

It is important, briefly, to draw from some findings of this study as it also studied South Africa's policy-making process. This study shows various platforms and stages of policymaking in South Africa, which we believe highlight the points of entry for policy learning and transfer. The SBP study was commissioned by the South African Presidency and the National Treasury to enquire into the relevance of using the Regulatory Impact Analysis (RIA) tools when establishing the country's regulatory framework in various issue areas. The study is entitled *Investigation of*

[562] See *Ibid.*
[563] See here http://www.sbp.org.za/ for more on SBP, a private sector development and research company based South Africa.
[564] SBP. 2005. *Investigation of the Possibilities for Regulatory Impact Analysis in South Africa*. A Study Prepared for the Presidency and the National Treasury. Executive Summary: Phase 1 to 3. http://www.sbp.org.za/uploads/media/RIA_SBP_project_for_SA_presidency__Treasury_Summary.pdf

the Possibilities for Regulatory Impact Analysis in South Africa. RIA is reportedly widely used in the OECD countries[565]. The OECD has guidelines, which were published in 1995, for use by its member countries when implementing new or evaluating old regulatory measures[566]. The main aspects of RIA are geared to assessing the costs and benefits of regulation. Its proponents believe that RIA assists in minimising the costs and the negative, undesirable and unintended consequences of regulation, while enhancing positive regulatory outcomes and benefits[567]. The SBP study arose from, among other things, concerns that small businesses had to comply with a lot of costly business regulations, thus disadvantaging them as compared to larger businesses that could easily internalise such costs[568]. These concerns by businesses are reflected in a survey conducted by the SBP consortium in 2004 entitled *Counting the Cost of Red Tape for Business in South Africa*[569].

The SBP study for the Presidency and the Treasury involved interviews with about 50 government officials[570]. Among other things, it enquired into the departmental regulation-making processes in South Africa. The study found that there are four main 'triggers' for regulation in South Africa. These were 'political instructions' from the minister or cabinet, 'stakeholder approaches', 'the need to meet international standards' or departmental research[571]. With respect to 'political instruction', the study notes that sometimes a political instruction to regulate could be the outcome of any of the latter three triggers rather than a cause for regulation[572]. However, when

565 *Ibid.* Kirkpatrick, C., Zhang, Y.F. & Parker, D. 2004. Regulatory impact assessment in developing and transitional economies: a survey of current practice. *Public Money and Management*, Vol. 24 (5) pp.291-296.
566 *Ibid.*
567 SBP. 2005. *Investigation of the Possibilities for Regulatory Impact Analysis in South Africa*. A Study Prepared for the Presidency and the National Treasury. Executive Summary: Phase 1 to 3. http://www.sbp.org.za/uploads/media/RIA_SBP_project_for_SA_presidency__Treasury_Summary.pdf
568 *Ibid.*
569 SBP. 2004. *Counting the Cost of Red Tape for Business in South Africa,* Johannesburg, November 2004, *http://www.businessenvironment.org/dyn/be/docs/33/RSARedTape.pdf*
570 SBP. 2005. *Investigation of the Possibilities for Regulatory Impact Analysis in South Africa*. A Study Prepared for the Presidency and the National Treasury. Executive Summary: Phase 1 to 3. http://www.sbp.org.za/uploads/media/RIA_SBP_project_for_SA_presidency__Treasury_Summary.pdf
571 *Ibid.* p.14.
572 *Ibid.*

this ‘political instruction’ is issued “it is more in the nature of a political ‘go-ahead’”[573] following from either stakeholder approaches or the need to meet international standards or based on departmental research. However these three triggers may sometimes result in a decision not to regulate[574].

On the policy-making process, the report finds that after the ‘triggers’ are ‘pulled’, so to speak, a political decision to regulate is often taken. Then there is an initial process that takes place within the department concerned, where sometimes departmental task teams are formed to “translate the broad policy commitment[s] into detailed policy goals”[575]. The SBP study does not mention what the sources of such policies are. In South Africa, as in many other modern democracies, the source of policy is the democratic process of the election. Prior to an election, political parties generally host elective conferences where they draw up resolutions and election manifestos. The missing ‘trigger’ in the SBP study is therefore the ruling party policy conference resolutions which highly influence policy positions/changes. These broad political party policies are translated into departmental Green and White policy papers. The SBP study’s policy-making process therefore starts at a departmental level, which should in effect be the second phase.

The SBP study emphasises that the lawmaking process is not uniform for every department and may depend on issues that are being tackled. It finds that during the initial departmental processes of lawmaking, the South African Department of Health, for instance, often relies on international partners such as the World Health Organisation and the Codex Alimentarius for research, while the Department of Justice relies on research conducted by the South African Law Reform Commission[576]. This latter finding is important because the AML regime was, at the early stages, researched by the South African Law Reform Commission (SALRC). These initial departmental processes involve consultation with stakeholders, research and sometimes

[573] *Ibid.* p.15.
[574] *Ibid.* p.18.
[575] *Ibid.*
[576] *Ibid.* 19.

international study tours, which then culminate in the production of various papers (Green and White Papers, Discussion Documents, Issue Papers) and draft legislation (Bills)[577].

In the drafting of Bills, a number of actors are involved. These include line function officials, departmental legal drafters, sometimes outside consultants, or even drafters instructed by a 'social partner'[578]. The latter is followed by ministerial approval, after which Bills are gazetted or recorded in the 'Cabinet Memorandum' and are approved by the Cabinet (which comprises the President, Deputy and various portfolio Ministers and their Deputies). The gazetting of a Bill introduces it to the parliamentary process where the wider public is called upon to make an input[579]. This process is followed by deliberations in the two houses of parliament, the National Assembly (NA) and the National Council of Provinces (NCOP). The general and main role of parliament is to make laws. The South African Constitution bestows the national legislative authority to the national parliament[580]. The Constitution also gives some limited law-making authority to provincial and local government[581], but the focus here is on the national level. In the parliamentary process, there are many deliberative processes that are followed which transform a Bill into an Act of Parliament. Once in the national parliament, many different interests colour the law-making process[582].

The National Assembly and the National Council of Provinces represent and accommodate different interests. The National Assembly is filled through proportional representation from party lists after an election and is taken 'to ensure government by the people'[583]. The National Council of Provinces, on the other hand, is filled proportionally from provincial lists and taken to represent the interests of the provinces at national level law making processes, particularly on areas of

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577 *Ibid.*
578 *Ibid.*
579 *Ibid.*
580 See Sections 42 (1), 43 (a), and 44 (a) of the *South African Constitution, Act 106 of 1996*.
581 See Sections 104 and 151 (2) *ibid.*
582 SBP. 2005. *Investigation of the Possibilities for Regulatory Impact Analysis in South Africa*. A Study Prepared for the Presidency and the National Treasury. Executive Summary: Phase 1 to 3. Retrieved from: http://www.sbp.org.za/uploads/media/RIA_SBP_project_for_SA_presidency__Treasury_Summary.pdf
583 *Ibid.*

concurrent legislative authority[584]. Both these houses of parliament have got what is called the portfolio committees for various exclusive and concurrent legislative functional areas[585]. In the law-making process, where the proposed laws affect the provinces, they must be deliberated upon in both the houses of parliament[586].

Sections 55 of the Constitution gives powers to the National Assembly to, among other things, initiate or prepare legislation, except money bills[587] and to consider, pass, amend or reject any legislation before it[588]. More or less similar powers are given to the National Council of Provinces by Section 68 (a) and (b). In the law making process of South Africa, there is an open invitation to the public and interested parties to make an input on proposed legislation. This invitation is not voluntary, but a duty of parliament to ensure that 'the people', and other interested parties, participate in the law making process[589]. These constitutional provisions provide that the NA and the NCOP 'must facilitate public involvement in the legislative and other processes' of parliament and its committees[590]. No new law in South Africa, therefore, can pass constitutional muster without any form of public involvement in its making.

This was recently clarified in a Constitutional Court case of *Doctors for Life v. Speaker of the National Assembly, 2006*[591]**.** In this case, an international advocacy group (known as Doctors for Life) operating in South Africa alleged that the NCOP did not invite public participation and deliberation before passing two pieces of legislation[592]. These two pieces of legislation were

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[584] South Africa is demarcated into 9 provincial governments which have the executive Premiers and provincial legislatures and administrations. The provincial legislatures enjoy some law making authority as provided for in Chapter 6 of the South African Constitution.
[585] See Schedule 4 of the *South African Constitution, Act 106 of 1996*
[586] See *Ibid.* Sections 44 and 45.
[587] See *Ibid.* Section 55 (1) (b).
[588] See *Ibid.* Section 55 (1) (a).
[589] See *Ibid.* Sections 59 (1) (a) and 72 (1) (a).
[590] *Ibid.* emphasis added.
[591] See also *Matatiele Municipality and Others v President of the Republic of South Africa and Others 2006* (5) SA 47 (CC). This is another Constitutional Court Case where the Court held that the legislative process failed to meet the constitutional obligation of public participation and deliberation in the re-demarcation of municipal boundaries in Matatiele, KwaZulu-Natal .
[592] The laws that were challenged by *Doctors for Life* were the *Traditional Health Practitioners Act* and the *Choice on Termination of Pregnancy Amendment Act*.

declared invalid by the Constitutional Court pending redress on public participation by parliament. The Court held that public participation is a constitutional duty that parliament must ensure in the lawmaking process. However, the Court noted that the Constitution does not appear to prescribe what public participation should entail and gives parliament some discretion on how to discharge this obligation[593]. The general practice by parliament has been to receive written and/or oral representations from the public and interested parties. The public would make representations on proposed Bills through the time-frames published in the government gazette. These representations would then be discussed by the relevant committees of both houses, mainly in joint sessions, or individually. Public hearings are also held, where both oral and written submissions are considered. The experts or departmental officials who drafted legislation are also invited to assist with clarifying issues and responding to representations, and in amending and/or rejecting the points made during representations. This involves accepting and making amendments to a Bill or rejecting such recommendations.

In these portfolio committees are parliamentary members of different political parties, who proportionally represent the interests of their constituencies (parties). They may hold markedly different views due to the multi-party composition of parliament. However, depending on the number of ruling party voting members in any of the committees, the ruling party always has its way, especially where the ANC has commanded majorities above 60% since 1994 and the voting is mainly along party-lines. In South Africa, where the ruling party commands such huge majorities, quite often, opposition parties abstain from voting if they do not like particular legislation or parts of them, or vote against such legislation.

The opposition almost stands no chance when it comes to voting. The minority parties' influence may after all rest on their lobbying and persuasion in the parliamentary deliberations and other platforms, not on voting, due to their numbers (even when all opposition parties are combined). As a result, what comes out from these processes may largely be influenced by the

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[593] See *Doctors for Life v. Speaker of the National Assembly, 2006.*

ruling party policies, whatever inspires them. However, there may obviously be instances where opposition parties are in agreement with the ruling party on a number of policy decisions and where law-making tends to be unanimously achieved through consensus.

Other findings of the SBP study on the law-making process in South Africa are that, in the initial phases, departments make use of departmental task teams. These task teams conduct research and develop policy discussion documents and, sometimes, Bills that are later deliberated upon in parliament. It is also in the initial phases in which external consultants, such as academics, international regulators and experts are engaged. Departments also engage in 'study tours' to foreign countries to learn more about how such countries have dealt with the problems at hand or other ends sought. It is therefore at these initial levels where policy transfer takes place. The study conducted by SBP for the Presidency and the Treasury appears to be a clear example of 'lesson drawing' by South Africa, driven by various actors from within. This may support the point that not all policies in developing countries are imported without contextualising them to local conditions and needs.

There are also very key provisions of the Constitution which appear to encourage policy transfer in South Africa. These are the provisions of Chapter 14 of the Constitution which refer to international agreements[594], customary international law[595], and to the application of international law[596]. With reference to international agreements, Section 231 and its subsections give the national executive, which is the Cabinet, the responsibility of negotiating and signing all international agreements. It further states that 'an international agreement binds the Republic only after it has been approved by resolution in both' the houses of parliament. However, not all international agreements are subject to approval by parliament (see below).

[594] See s Sections 231 (1), (2), (3), (4) and (5) of the *South African Constitution, Act 106 of 1996*
[595] *Ibid.* Section 232
[596] *Ibid.* Section 233

Section 231 (3) provides that “an international agreement of a technical, administrative or executive nature, or an agreement which does not require either ratification or accession, entered into by the national executive, binds the Republic without approval by [parliament], but must be tabled in [both the houses of parliament] within a reasonable time”. This provision seems to give carte blanche powers to the executive and it is quite interesting when it comes to the FATF AML standards because they could easily be legitimited through mere tabling in parliament, as they do not require accession or ratification, are considered technical or administrative, and are a product of non-binding international soft-law. This provision reads like the Constitution allows the country to be bound by such technical agreements, subject to the Cabinet entering into them and without the approval of parliament. However, such agreements, technical or administrative as they may be, may have very profound implications for the country.

Section 231 (4) provides that any international agreement becomes law of the Republic when it is enacted into law through national legislation. This subsection further provides that “a self-executing provision of an agreement that has been approved by Parliament is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament”. The last provision in relation to international agreements is that South Africa is ‘bound’ by agreements which were entered into before the Constitution came into effect on May 1996. Indeed, South Africa signed or entered into a number of agreements with other countries prior the elections of 1994 and soon thereafter but before the final Constitution came into force[597].

Section 232 provides that ‘customary international law is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament. Lastly, the constitution appears to give unfettered powers to the judiciary in terms of section 233. This section provides thus:

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[597] See, for instance, Dugard, J. and Currie, I. 1995. *Public International Law, Annual Survey of South African Law 1995*. Juta & Co, Ltd, pp. 76 to 97 and Dugard, J. & Currie, I. 1996. *Public International Law, Annual Survey of South African Law 1996*. Juta & Co, Ltd, pp.145-174 for a list of agreements entered into in 1995 and 1996 respectively.

> "When interpreting any legislation, every court must prefer any reasonable interpretation of the legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law."

This seems to elevate international law above national legislation and allows the judiciary to play an active role of transplanting and creating law through legal precedent.

Policy transfer and the global AML regime

The literature on policy transfer has hardly examined the dissemination of AML/CTF policies to developing countries. However, over the past couple of years there has been some intellectually stimulating work on why the AML regime spread throughout the globe so quickly. This includes prominently the work of Drezner[598], H*ü*lsse[599], Sharman[600], Mitselegas[601], Bosworth-Davis[602], among others. Drezner, H*ü*lsse and Sharman have sought to analyse, albeit in different ways, how the AML regime expanded from the US into the rest of the world in the past two and half decades. Bosworth-Davis[603], on the other hand, has traced the spread of these policies from an earlier period than these three authors (Drezner, Hülsse and Sharman). He traced it to the 1970s, when the US first introduced financial regulations through the Bank Secrecy Act of 1970. The work of these authors is directly linked to my analysis here. Before we review this work, we start by offering a short history on the origins of AML policies.

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[598] Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy, 12*(5), 841-859.
[599] H*ü*lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.
[600] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.
[601] Mitsilegas, V. 2003. Countering the chameleon threat of dirty money: 'hard' and 'soft' law in the emergence of a global regime against money laundering and terrorist finance. in A. Edwards & P. Gill (Eds.). *Transnational organised crime: perspectives on global security.* (pp. 195-209.). London: Routledge.
[602] Bosworth-Davies, R. 2006. Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*: pp.346-364.
[603] *Ibid.*

While some scholars[604] have merely focused on the role played by the FATF, they have failed to enquire into where these AML policies originate from. We contend that they have missed or ignored the rhetoric and threats of economic sanctions which was later to be used by the FATF, thus attributing some great achievements to it (the FATF), when it was merely a conveyor belt of US policies. The analysis of these authors (Drezner, Hülsse and Sharman), therefore, tends to conflate the role played by the FATF which, we argue, merely represented US and other interests in the global diffusion of the AML regime. We further claim that the US interests that the FATF represented were not necessarily and primarily directed at the combating of money laundering. Bosworth-Davis[605] has offered some analysis in this respect, which we concur with, although not done in the context of policy transfer analysis. What we do here is to link this history to policy transfer analysis. We then briefly review the work of Drezner, Hülsse and Sharman and from this we define a scheme for determining whether South Africa's incorporation of the FATF standards could be viewed as voluntary or coercive. The importance of determining the nature of South Africa's incorporation of the FATF regime informs our argument, in Chapter 8, concerning the regime's legitimacy crisis.

While we use the policy transfer literature, which Sharman[606] also uses, our approach is to examine the history of the global AML regime (its ideas, techniques, strategies, and experiences), not only from a global level, but from the viewpoint of the AML regime's exporting country, the US. We argue that the UN Vienna Convention on Drugs and Psychotropic Substances of 1988, which introduced money laundering as an offence to the rest of the world, and the FATF's 40 Recommendations on Money Laundering, represent different pathways of policy transfer; that is

[604] See Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy, 12*(5), 841-859. H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178. Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.

[605] Bosworth-Davies, R. 2006. Money Laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp.346-364.

[606] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.

transfer from the US to other developed countries, and from the US to the global level We argue that the UN Vienna Convention and the FATF standards did not invent anything substantive, but exported, in a very coordinated, systematic manner—existing US policies and made them global standards, which were then transplanted in various ways to the rest of the world and imposed on developing countries. Without the organized crime policies of the US, which we describe below, there would probably be no global AML regime. The question that needs to be addressed, therefore, is why the US wanted its internal policies to be replicated globally, even through use of force— where persuasion failed? What and whose interests would the global diffusion of its crime control policies serve?

We, in this regard, incorporate the theories of regulation to enquire into the interests involved in the US's drive for the worldwide exportation of its policies and laws. We contend that this could best be explained by looking at the history of the AML financial regulations in the US in the 1970s, which resulted from decades of US's inclinations to fight organized crime from the late 1920s onwards. `

The origins of global AML policy ideas, contents and experiences

As mentioned above, for Drezner, Hülsse, and Sharman the analysis of the diffusion of AML standards either start in 1986, when the US passed the Money Laundering Control Act of 1986 to the UN Vienna Convention against Illicit Drugs and Psychotropic Substances of 1988 (the Vienna Convention) which required signatories to criminalize the laundering of proceeds of crime and the formation of the Financial Action Task Force and its Forty Recommendations of 1990. This narrative however misses the origins of what had influenced the culmination of the global AML regime and does not assist in explaining the interests involved in the dissemination of the regime. The UN and the FATF were merely conveyor belts or agents of the transfer of US policy on organized crime and related financial regulation. Most concepts, ideas and rhetoric contained in the Vienna Convention had been developed and harnessed for years in the US. Also, the FATF's 40 Recommendations were copied from the policies, ideas, and experiences which had for years been in operation in the US.

Scholars such as Michael Woodiwiss have chronicled the US's war against organized crime, which can be traced back to the 1920s. In the late 1920s, the prohibition on alcohol was depicted as having "introduced the most difficult problems of law enforcement in the field of organized crime" in the Illinois Crime Survey of 1929[607]. Commentators suggested that "organized crime was one of the unfortunate products of unfettered capitalism" which required "more rigorous business regulation" to minimize its penetration of "legal markets"[608]. Michael Woodiwiss has argued that despite this rhetoric and the US's analysis of organized crime, the US never pursued "policies that reduced opportunities for successful organized crime activity"[609]. This rhetoric was revived in the 1950s, with a report by Senator Estes Kefauver's Senate Investigating Committee into Organised Crime[610]. This report depicted the Italian Mafia as 'dominating organized crime' and as a "coherent and centralized international conspiracy of evil"[611]. The declamations and explanations that Hülsse[612] admirably describes in analyzing the FATF's discursive strategies in spreading the AML regime throughout the globe can be observed from these early years (1920s to 1950s) in the US.

The Mafia, in the US, was depicted as a "threat to America's political, economic and legal systems dominating "gambling and drug trafficking" and branded as having "weakened the vitality and strength of the nation"[613]. In the late 1960s, under President Johnson, a Crime Commission

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[607] Woodiwiss, M. (2003). Transnational organised crime: the global reach of an American concept. In A. Edwards & P. Gill (Eds.), *Transnational organised crime: perspectives on global security* (pp. 13-27). London, : Routledge. p. 14.
[608] *Ibid.*
[609] *Ibid.* p.15.
[610] *Ibid.*
[611] *Ibid.*
[612] H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.
[613] Woodiwiss, M. (2003). Transnational organised crime: the global reach of an American concept. In A. Edwards & P. Gill (Eds.), *Transnational organised crime: perspectives on global security* (pp. 13-27). London:

was formed and released another report in 1967[614]. This report described organized crime as "a society" that sought "to operate outside the control of the American people and their governments" involving "thousands of criminals, working within structures as complex as those of any large corporation" and involved in "conspiracies…aimed at gaining control over whole fields of activity in order to amass huge profits"[615]. All this rhetoric of official Commissions and reports led to the passing of the very first laws in the history of AML. The first law was the Omnibus Crime Control and Safe Streets Act of 1968[616]. The major contribution of this latter law was its provisions for electronic wiretapping and eavesdropping[617]. Finklea writes that this Act immediately provided US 'law enforcement and policymakers with an indication of organized criminal activities, especially their involvement in illegally importing and distributing narcotics'[618].

In 1970, two further major statutes were passed on which the global strategies for fighting money laundering evolved. These were the Organized Crime Control Act (OCCA) and the Bank Secrecy Act (BSA). The OCCA gave powers to federal US law enforcement agencies to seize the financial assets or proceeds of crime through its Racketeer Influenced and Corrupt Organizations (RICO) provisions[619]. Although the OCCA focused on offences beyond drugs, the UN Convention only required criminalization of proceeds of drugs[620]. The criminalization of proceeds of other offences at a global level was gradually introduced by the FATF and other later crime-related UN Conventions. The Bank Secrecy Act of 1970 was enacted to 'facilitate Federal financial investigations of illegal activities, such as drug trafficking and tax evasion'[621]. It required individuals and financial institutions to report domestic currency transactions of US$10000.00 and

Routledge. p. 15

614 *Ibid.*

615 *Ibid.* p.16.

616 See Finklea, K.M. 2010.Organised crime in the United States: Trends and Issues for Congress. Congressional Research Service: Report for Congress, pp.1-32, p.5.

617 *Ibid.*

618 *Ibid.*

619 See 18USC, Section 1961-1968

620 *United Nation's Vienna Convention on Illicit Drugs and Psychotropic Substances* of 1988, Article 3

621 GAO. 1979. *The Use of Currency and Foreign Accounting Reports to Detect Narcotic Traffickers.* United States Government Accountability Office, Washington DC, p.3.

above[622]. It also required the filing of reports on importation and exportation of currency or monetary instruments above US$5000.00[623]. Currency reports were filed by the US's domestic financial institutions to the Internal Revenue Service (IRS)[624]. In 1979 the US's General Accounting Office made three reports to the Congressional House Committee on Banking, Finance and Urban Affairs.

The first one was presented to the House's Subcommittee in April 1979 and was entitled *Better Use of Currency and Foreign Account Reports by Treasury and IRS Needed for Law Enforcement Purposes*. It reviewed IRS's use of currency transaction reports, international transportation of cash or currency reports and reports of foreign banks, securities, and other 'financial accounts'[625]. The main finding of this report was that the customer transaction reports that were filed with the IRS were "not useful to IRS as the Congress might have expected when it established the reporting requirements"[626]. It further opined that an improved use of the reporting forms "alone would not resolve such problems as tax evasion and drug trafficking" but could help the federal agencies to "deal with these problems"[627]. This report further recommended that instead of the reports being made to the IRS, they should instead be filed with a central agency to be located within the US Treasury, which will analyse and disseminate them to the relevant law enforcement agencies for investigations[628]. The latter task is more or less what is done by the Financial Intelligence Units in most countries that adopted the FATF's 40 Recommendations.

The second report, published in October 1979 and entitled *Gains made in controlling illegal drugs, yet the drug trade flourishes* assessed the Federal Government's drug enforcement

622 *Ibid.*
623 *Ibid.* p.4
624 *Ibid.*
625 GAO. 1979. *Better use of currency and foreign account reports by Treasury and IRS needed for law enforcement purposes*. United States Government Accountability Office, Washington DC.
626 *Ibid.* p. i.
627 *Ibid.*
628 *Ibid.*

and supply control efforts for the years between 1969 and 1979[629]. It is important to refer to this report in some length because it shows that already around that time (1979) the US officials were proposing the exportation of US's drug control strategies, ideas and experiences abroad in a very coordinated manner. This report chronicled many of the problems that the US had with illegal drugs, but most importantly, made some suggestions on how the US could deal with them. One of these problems was that the social, economic and political realities of drug-growing countries made it

> "…difficult to prevent cultivation of illicit crops and stop trafficking at the source. Most producing nations are poor, underdeveloped, struggling countries presenting problems that are too complex for a predominantly law enforcement approach to be effective in reducing drug supplies"[630].

Another finding was that there were enormous profits in drug trade, to the extent of between US$35 billion to 51 billion per annum in the US alone[631]. One of the recommendations said that governments of developed countries and international financial institutions must provide "no support for illicit drug production"[632]. The report further cautioned that

> "The United States has been the prime force in efforts to control illicit drug production, but increased commitment of developed countries is needed if we are to have a great impact on the problem…the Secretary of State, with the support of the Congress, [must] promote a world conference and the formation of a consortium of victim countries that would develop a plan of action to fight the global drug problem in a unified way"[633]

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[629] See GAO. 1979. *Gains made in controlling illegal drugs, yet the drug trade flourishes.* United States Government Accountability Office, Washington DC GAO.
[630] *Ibid.*
[631] *Ibid.*
[632] *Ibid.*
[633] *Ibid.* p. viii

Michael Woodiwiss has argued that the intentions of the US to internationalise its drug prohibition policies was "a response to its own organized crime problems"[634]. The drug issue, at that time, was already an international concern with three previous anti-drug international conventions already signed before the UN Vienna Convention of 1988. These conventions included one by the then League of Nations in 1925[635] and another two conventions developed by the UN in 1961[636] and 1971[637]. Even the second GAO report recognizes that

> "Foreign governments have long recognized the international implications of drug abuse by entering into international treaties and conventions, and by supporting international organizations such as UNFDAC. Within their own countries, narcotics laws have been passed, enforcement efforts have disrupted drug trafficking, and some radical measures, such as eradication and crop substitution, have been undertaken"[638]

If foreign governments had long recognized and taken action to solve the problem, what then was the problem this time? The GAO report expressed reservations as to whether the

> "…international community is seriously committed to resolving the drug abuse problem. Foreign countries provide little assistance in helping the United States prosecute fugitives, traffickers, and financiers who live or conduct business in their countries…and their bilateral and multilateral support is insufficient to achieve the needed impact…"[639]

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[634] Woodiwiss, M. (2003). Transnational organised crime: the global reach of an American concept. In A. Edwards & P. Gill (Eds.), *Transnational organised crime: perspectives on global security* (pp. 13-27). London: Routledge. p.18.

[635] This was called the *International Opium Convention* of 1925 adopted in Belgium, which replaced the 1912 Hague Convention.

[636] See the *United Nation's Single Convention on Narcotic Drugs* of 1961. http://www.incb.org/pdf/e/conv/convention_1961_en.pdf

[637] See the *United Nation's Convention on Psychotropic Substances* of 1971.

[638] GAO. 1979. *The Use of Currency and Foreign Accounting Reports to Detect Narcotic Traffickers.* United States Government Accountability Office, Washington DC, p. 49.

[639] *Ibid.* 49.

The US officials at GAO felt that they were not getting the cooperation they needed. This is one of the emphases of the Vienna Convention of 1988; cooperation in the form of mutual legal assistance, extradition treaties, extraterritorial offences and harmonisation. The FATF also emphasises this cooperation in its recommendations 35 to 40 of its standards.

The third report was a statement made by Associate Director, Richard Fogel, of the General Government Division, which fell under the GAO, to the House Committee on Banking, Finance and Urban Affairs in November 1979 entitled *The Use of Currency and Foreign Accounting Reports to Detect Narcotic Traffickers*. In this statement, GAO advised the Committee on how the Bank Secrecy Act reporting provisions could assist federal law enforcement agencies in detecting financial transactions related to drug trafficking activities[640]. In this statement Fogel maintained that '[e]ffective law enforcement in the drug area requires that major traffickers be immobilized…and seizing their financial resources—the key element to immobilization…'[641]. He then went through the astonishing and unverifiable figures of a US$51 billion drug industry in the US and concluded that "the large amounts of income from drug sales probably most often go unreported for income tax purposes…up to US$24 billion in unreported income in 1976 came from illegal drug activities"[642]. He observed further that

> "Large amounts of cash are essential to the illegal drug business but create problems for traffickers. Cash must be transported when dealers engage in transactions or stored securely so as not to be detected, yet it must be readily available when needed. Thus, knowledge of money flows along with other information is essential to identifying and immobilizing drug traffickers."[643]

[640] GAO. 1979. *The Use of Currency and Foreign Accounting Reports to Detect Narcotic Traffickers.* United States Government Accountability Office, Washington DC.
[641] *Ibid.* p.1.
[642] *Ibid.*
[643] *Ibid.* p.2.

From 1970, there were concrete steps put in place by the US to attack the proceeds of crime with the coming into force of OCCA and the BSA. However the three review reports, cited above, compiled by the GAO show that US officials were unhappy with the progress made. They had problems when it came to cooperation, the usefulness of the regulatory reporting requirements on financial institutions and cross-border flows of cash and they abhorred the profitability of the drug industry and the fact that it brought about billions of losses to the taxman in unreported income tax. Another Presidential Commission to investigate organized crime was appointed by President Reagan in 1983[644]. This Commission was to

> "make a full and complete national and region-by-region analysis of organized crime; define the nature of traditional organized crime as well as emerging organized crime groups, the sources and amounts of organized crime's income, and the uses to which organized crime puts its income"[645]

It was also to advise the President and the Attorney General on "actions which can be undertaken to improve law enforcement…"[646] After three years of deliberations, which included public hearings, the Commission published its report in 1986. It is the findings of this Commission which came up with the offence of 'money laundering' and which led to the amendment of title 18 of the US Code to create a federal offence under the Money Laundering Control Act of 1986. All these features of the US law, policies, ideas and experiences, as discussed above, would shape the Vienna Convention of 1988 and the FATF standards. It is important to go through what was copied/emulated by the Vienna Convention and the FATF from the US and elsewhere. We start here with the Vienna Convention.

[644] *President's Commission on Organised Crime*. Ronald Reagan, The White House, Executive Order 12435, United States, 28 July, 1983.
[645] *Ibid.*
[646] *Ibid.*

Vienna Convention: policy learning and transfer

The Vienna Convention was a result of the UN deliberative processes initiated in 1984[647]. This was the period when the US was busy with its public hearings by the Reagan Presidential Commission on Organized Crime which had started in 1983. Around this time, the FBI had achieved some major breakthroughs with the trials of the Italian Mafia throughout the US[648]. These trials had received so much publicity and earned a special attention from the movie-makers in Hollywood. The Vienna Convention of 1988 was formulated against the backdrop of these US breakthroughs when it came to dealing with organized crime and drug trafficking. It is important to note that the Convention emphasized only three core features of the global AML regime, because the US appears to have either failed to export the whole regime through the Vienna Convention or deliberately chose a different platform, the establishment of the FATF, to champion further regime transfers (see below).

The Vienna Convention dealt with the criminalization of money laundering, the seizure and forfeiture of proceeds of drugs and international cooperation[649]. All these issues had been chronicled by the US officials in the reports and laws discussed above, particularly the report dealing with drugs[650]. The Vienna Convention was therefore highly influenced by US laws, policies, experiences and strategies in dealing with organized crime and drug trafficking. Nadelman, for instance, points out that;

> "The modern era of international law enforcement is one in which U.S. criminal justice and U.S. models of criminalization and criminal investigation have been exported abroad. Foreign governments have responded to U.S. pressures,

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[647] See *United Nation's Vienna Convention on Illicit Drugs and Psychotropic Substances* of 1988.

[648] Woodiwiss, M. (2003). Transnational organised crime: the global reach of an American concept. In A. Edwards & P. Gill (Eds.), *Transnational organised crime: perspectives on global security* (pp. 13-27). London: : Routledge.

[649] See *Ibid.*

[650] See GAO. 1979. *Better use of currency and foreign account reports by Treasury and IRS needed for law enforcement purposes*. United States Government Accountability Office, Washington DC.

inducements, and examples by enacting new criminal laws regarding drug trafficking, money laundering, insider trading, and organized crime…"[651]

Michael Woodiwiss observed that while drug trafficking was only one of several illegal activities that transcended national boundaries "the American war on drugs has provided the crucial impetus for a host of actions and agreements that otherwise would never have occurred"[652]. However there are two key features of the global AML regime that were not dealt with in the Vienna Convention. These are the proposals for the establishment of financial intelligence units and the regulation of, primarily, financial institutions and intermediaries in combating drug-related money laundering.

While these had been a key feature of the US's onslaught on organized crime and drug trafficking since the 1970s, they did not form part of the articles of the Vienna Convention of 1988 which begs the question: Why did these two key features of the global AML regime not become part of the Vienna Convention? This appears to be because the US wanted financial regulation to form part of the regime. The signs of this are that soon after the Vienna Convention, the FATF was formed on US's instigation and the only new features it proposed were the financial regulations and the establishment of Financial Intelligence Units.

FATF standards: policy learning and transfer

The FATF was formed shortly after the UN Vienna Convention was adopted. The question is why would the FATF be formed to deal with similar issues that the Vienna Convention had just

[651] Nadelman, E. 1993. Cops across borders: the internalization of U.S. Criminal Law Enforcement, pp. 469-70. cited in Woodiwiss, M. 2003. Transnational organised crime: the global reach of an American concept. In A. Edwards & P. Gill (Eds.), *Transnational organised crime: perspectives on global security* (pp. 13-27). London:: Routledge.

[652] Woodiwiss, M. 2003. Transnational organised crime: the global reach of an American concept. In A. Edwards & P. Gill (Eds.), *Transnational organised crime: perspectives on global security* (pp. 13-27). London: Routledge.

tackled; the evils of illicit drugs and the problem of money laundering? The official explanation is that the FATF was formed to enquire into what the G7 countries could do to prevent the use of financial institutions by drug traffickers to launder money. The FATF would then advise these countries on the best possible strategies and their implementation. The Basel Committee on Banking Supervision had already issued its Statement of Principles on the *Prevention of Criminal Use of the Banking System for the purposes of Money Laundering* in December 1988, urging national financial regulators and private banks to adopt measures to safeguard their systems from being abused by criminals to launder criminal proceeds[653].The Declaration of the G7 Paris Summit of Heads of Government recommended that they:

> "Convene a financial action task force from Summit participants and other countries interested in these problems. Its mandate is to assess the results of cooperation already undertaken in order to prevent the utilisation of the banking system and financial institutions for the purposes of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance. The first meeting of this task force will be called by France and its report will be completed by April 1990."[654]

The establishment of the FATF was first mooted in 1988, during the G7 Heads of Government Summit in Harrisburgh, Pennsylvania in the US, but France opposed its establishment then[655]. It is unclear why France opposed the formation of the FATF. However, in the following year, when a similar summit was held in Paris, the issue was again placed on the agenda by France on conditions that it became the first chair of this proposed body and that the FATF would also

[653] See Basel Committee on Banking Supervision. 1988. *Prevention of Criminal Use of the Banking System for Purposes of Money Laundering*. (December 1988). *http://www.bis.org/publ/bcbsc137.pdf*
[654] https://www.g7.utoronto.ca/summit/1989paris/communique/drug.html. Released by the Summit on July 16 1989.
[655] Pieth, M. & Aiolf, G. 2003. Anti-money laundering: levelling the playing field. *Governance*, Basel Institution of Governance, p.9.

tackle tax issues[656]. However other countries that were invited by France to the Paris Summit, particularly Luxemburg, Switzerland and Austria refused to support the formation of the FATF unless tax issues fell outside its remit[657]. Only when a compromise was reached was the FATF finally formed in 1989[658]. In April 1990 the FATF submitted its report to the G7 Heads of Government in which it came up with the 40 Recommendations against Money Laundering. It proposed that its members should implement and comply with these standards in order to combat money laundering more effectively, while also fostering the safety of the global financial system from usage by criminals. The FATF also came up with a peer review mechanism known as the 'mutual evaluation programme'. This latter programme would help it to assess its member countries' progress in implementing the standards.

The FATF's 40 Recommendations focused on five core features of the global AML regime. The first three of these features are those already covered by the Vienna Convention, which are criminalization of money laundering[659], seizure and forfeiture of proceeds of crime (initially drugs)[660], and international cooperation[661]. The last two that— for whatever reason— were not incorporated into the Vienna Convention are the regulations on financial institutions to combat money laundering[662] and later the establishment of Financial Intelligence Units[663]. As discussed above, these ideas, laws, policies and practices of regulating businesses started in the 1970s in the US. The first proposal for the establishment of an FIU-type institution in the US Treasury was mooted in 1979[664]. The reporting of suspicious, threshold and cross-border transactions, in compliance with the Bank Secrecy Act of 1970, were initially made to the IRS and Customs in the early 1970s. Other law enforcement agencies could however not access the reports made to the

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656 *Ibid.*
657 *Ibid.*
658 *Ibid.*
659 Recommendation 1 to 2 of FATF's Forty Recommendations Against Money Laundering of 1990.
660 *Ibid.* Recommendation 3.
661 *Ibid.* Recommendation 35 to 40.
662 *Ibid.* Recommendation 4 to 25.
663 *Ibid.* Recommendation 26 to 34 .
664 See GAO. 1979. *Better use of currency and foreign account reports by Treasury and IRS needed for law enforcement purposes*. United States Government Accountability Office, Washington DC.

IRS and Customs because of tax confidentiality issues[665]. As a result, this function of receiving, analysing and disseminating suspicious customer reports to investigating agencies was reassigned to the Treasury, which would not be bound by similar tax confidentiality issues as the IRS and Customs were[666].

These mandatory suspicious, threshold and cross-border transaction reports then started to be channelled to the Treasury in the late seventies and early eighties, as a clearing house for their dissemination to law enforcement agencies, which would then investigate them. In 1990, the US eventually launched the Financial Crimes Enforcement Network (FinCEN) under the US Treasury; the first FIU in the world. The concept of FIU's then became part of the recommendations of the FATF and led to the formation of the Egmont Group of Financial Intelligence Units in 1994.

In all this history, we have shown that the original source of the global AML standards was mainly the US. The UN and the FATF were just mere agents of US policy transfer to the rest of the world, through both hard and soft law mechanisms. This is often overlooked by many scholars. It is important to emphasise that nothing substantively new, whatsoever, was proposed by the FATF Recommendations of 1990, but the emulation/copying of existent US policies, and infusing these with customer due diligence regulations from Switzerland[667]. If the FATF is to be credited with any achievement, it is in the manner in which it packaged these policies into a set of standards and put in place the regulatory strategies and techniques of securing world-wide compliance, mainly through coercion under its arbitrary NCCT blacklists which targeted non-FATF and mainly developing countries.

We have briefly dealt with the history of the origins of organized crime and drug trafficking policies in the US and its official responses to it in light of its influences on the UN Vienna Convention of 1988 and the FATF standards. However there are a number of issues that remain

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665 *Ibid.*
666 *Ibid.*
667 See Pieth, M. & Aiolf, G. 2003. Anti-money laundering: levelling the playing field. *Governance*, Basel Institution of Governance, on the origins of customer due diligence.

unaccounted for in this history. The first one is why would the US desire its internal policies to be exported globally? Secondly, why did it use different forums to disseminate these policies - the UN, to lobby specifically for the criminal and asset forfeiture aspects of the global AML regime and the FATF for the financial regulatory aspects? Was the use of multiple forums to disseminate the regime perhaps a classic example of what is referred to as 'forum-shifting'. Ngaire Woods has argued that powerful countries have the luxury of 'shopping-around' and shifting global decision making to forums most suitable to serve their, mostly, narrow interests?[668]

The UN was much more an inclusive body as compared to the FATF, with developed and developing countries represented in the conferences and deliberative processes that led to the adoption of the Vienna Convention. On the other hand, the FATF was only comprised of developed countries and deliberately excluded developing countries from participation. A possible explanation is that the US failed to push for the financial regulatory measures through a more inclusive forum, the UN but opted instead for a body that it could control in order to further its interests.

Let us tackle the questions raised above using the available evidence, starting with why the US seem to have desired its policies to become international, global rules and exported to various countries. We refer mostly to Chapter 2 of this thesis and mostly to the work of Bosworth-Davis[669]. The issue at stake here, we argue in agreement with Bosworth-Davis, was 'regulatory arbitrage'. The regulation of banks to perform anti-money laundering functions in the US, we contend, and non-regulation of such issues in other competitive jurisdictions was at the core of US's drive to disseminate the regime globally. While the US had regulated its banks to perform anti-money laundering roles, through the Bank Secrecy Act of 1970, in the 1980s, other major financial markets of Europe had not done so[670]. There was therefore a view among some US Senators and

[668] See Woods, N. 2007. Global governance and the role of institutions. In D. Held & A. G. McGrew (Eds.), *Governing globalization: power, authority and global governance* (pp. 25-45). Oxford: Polity on 'forum-shifting'
[669] Bosworth-Davies, R. 2006. 'Money Laundering: towards an alternative interpretation-chapter two.' *Journal of Money Laundering Control,* pp.346-364.
[670] *Ibid.* 355.

private banks that such stringent and burdensome AML regulations would make them less attractive to investment and therefore less competitive as compared with other equivalent markets of Europe or other jurisdictions[671], particularly the so-called regulatory havens. Bosworth-Davis explains this well;

> "The US private banks wanted to be able to compete with the more traditional players, the Swiss and the British…but the new anti-money laundering laws made the US a less attractive place in which to carry out…business, thus prejudicing US banks at the expense of other countries' banks in which such stringent anti-money laundering provisions did not apply. The world's super rich were being scared off by these new legislative rules…"[672]

Bosworth-Davis further quotes Senator John Kerry in a debate at the US Senate Committee on Banking, Housing and Urban Affairs where Kerry said

> "…If our banks are required to adhere to a standard…and other banks do not, and rush for (to acquire) deposits in those banks, we will have once again taken a step that will have disadvantaged our economic structure and institutions relative to those against whom we must compete in the marketplace…"[673]

Based on this evidence, we can reasonably conclude that the US's drive in spreading the regime globally was motivated by keeping its private banks competitive in globalised and liberalized financial markets. This may also explain why the US targeted mainly developed countries initially, as these were its direct competitors, especially the Swiss, the British and other similarly competitive financial markets. But this still does not explain why the AML regime spread to smaller and developing countries. It could be that the US just wanted to secure support for financial regulation using the combined market power of itself and other great powers, the EU and

[671] *Ibid.*
[672] *Ibid.*
[673] *Ibid.*

other developed countries. Its interests and those of other G7 members coalesced and propelled the regime beyond them, particularly as the FATF proclaimed the small Islands as regulatory/tax havens making them highly susceptible to money laundering. It was necessary then to demand that they observe FATF standards[674].

Regulatory/tax havens were regarded as competition by the major Western powers and continue to be the focus of many initiatives by the World Bank and the IMF's financial surveillance programmes as they attract large investments from companies and high net worth individuals for, among other things, their low tax rates[675]. Many developing countries cannot be seen as competition for the US and its G7 counterparts. So why were all compelled by the FATF to observe its standards? This is a difficult question to answer as most developing countries were not regarded as money laundering havens[676] but in this case the argument was cleverly turned on its head. Without the FATF standards, they would not be able to attract foreign investments and would be susceptible to outbound-flows of laundered money, especially from the corrupt political elite. All these would affect their much needed socio-economic development. The introduction of FATF standards in developing countries, it was claimed by the FATF, was directed at 'assisting' them in their socio-economic development endeavours by fostering good governance.

The FATF has played its role in diffusing its standards quite astutely, as shown by the work of Drezner[677], Hülsse[678] and Sharman[679]. The main issue, however, with the work of these scholars is that they seem to view the FATF as the primary driver of the global diffusion of AML standards.

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674 See Chapter 8 for more on the issue of regulatory and tax havens.
675 *Ibid.*
676 See Drezner, D. W. 2005. 'Globalisation, harmonisation, and competition: the different pathways to policy convergence.' *Journal of European Public Policy, 12*(5), 841-859. H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178. Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.
677 Drezner, D. W. 2005. 'Globalisation, harmonisation, and competition: the different pathways to policy convergence.' *Journal of European Public Policy, 12*(5), 841-859.
678 H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.
679 Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.

This is not completely untrue, but it obscures the origins of this regime and how these AML policies developed over time and the interests they camouflage – including the fact that such global standards were, substantively, nothing more than US policies. We now turn to look briefly at the work of Drezner[680], Hülsse[681] and Sharman[682]. This helps us to devise a scheme to determine whether South Africa adopted the AML regime voluntarily or coercively. It also helps us to test our hypotheses about the incorporation of the global AML regime in South Africa. We start with the work of Drezner.

The work of Drezner is based on a game theoretical model of policy coordination and argues that the spread of AML standards to the rest of the world was occasioned by policy convergence between the 'great powers', the US and the EU[683]. His argument is that where developed countries agree on particular policy objectives and strategies, policy convergence and harmonisation will most likely occur[684]. Where and when they do not agree, they create sharp lines of policy divergence or competition, which often lead to polarization or competing global regimes which are led by the disagreeing great powers. The example he gives of this latter scenario is where the US and the EU are in disagreement on issues relating to Genetically Modified Organisms and have created two competing global regulatory regimes[685]. Drezner identifies the Financial Action Task Force as the 'coordinating forum' for the US and EU to bring about policy convergence on issues of money laundering control. He explains that when the FATF was formed, its task was to look at coordinating anti-money laundering efforts among developed countries only (i.e. the US, EU, Japan, Canada and Australia). It appears from his analysis that developing countries were brought in as an afterthought.

[680] Drezner, D. W. 2005. 'Globalisation, harmonisation, and competition: the different pathways to policy convergence.' *Journal of European Public Policy, 12*(5), 841-859.
[681] H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.
[682] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.
[683] See Drezner, D. W. 2005. 'Globalisation, harmonisation, and competition: the different pathways to policy convergence.' *Journal of European Public Policy, 12*(5), 841-859 pp.843-844.
[684] *Ibid.*
[685] *Ibid.* p.853.

Drezner examines what he sees as coercive elements in the regulatory strategies and techniques of the FATF concerning the spread of the regime to developing countries. This coercive element was punctuated, according to him, by the FATF's development of NCCT blacklists. These blacklists have been unilaterally compiled by the FATF since 2000, naming and shaming some countries it had assessed and found non-compliant with its standards. Blacklisting was also sometimes backed by overt economic threats by the G7 countries. The G7 issued a statement in 2000 where it pledged support for the NCCT blacklisting campaign which named and shamed 27 countries and territories-- all non-FATF members. The G7 threatened these blacklisted countries with restricting their financial transactions with institutions based in G7 jurisdictions. It appears that many blacklisted countries responded to these threats by incorporating the FATF standards. These countries most obviously incorporated the FATF standards under duress. They were removed from the NCCT blacklists after they had 'made progress' to comply with the FATF recommendations.

This progress was in the form of enacting the FATF regime in their countries. Therefore, we can conclude that many other developing countries would have likely sought to avoid such sanctions and would have acted proactively before they were named and shamed. As a result, when the blacklisted countries were forced in response to pressure to incorporate the FATF standards, not only their compliance but also their proactive initiatives of other countries to avert sanctions could be interpreted as coercive transfer. What would a voluntary transfer of the AML/CTF regime look like? Hülsse (2007) focuses on the spread of the global AML regime through a variety of mainly discursive means, which, he argues, led to voluntary adoption of the FATF standards by many countries. He does not discount the coercive role played by the NCCT blacklists but rather puts emphasis on the 'soft power' dynamics of moral suasion used by the FATF in spreading its standards. His main argument is that international regulators engage in various forms of persuasion to convince others of a problem for which they then offer solutions.

According to Hülsse, these international organisations create a demand for the existence of international rules and standards (he calls this 'problematisation'), which they then promulgate and foster regimes to assure compliance. He claims that the FATF and those behind it (the G7) initially aimed at securing voluntary compliance with its standards. This entailed, he argues, not only persuading countries about the suitability or the relevance of the rules and standards themselves, but also persuading everyone about the existence of a 'problem' these standards were intended to solve[686]. He argues that it is easier to explain why states comply with international rules and standards if they had participated in their making and such rules serve their interests[687]. He further argues that even where inclusive participation is lacking, states are likely to embrace rules that serve their interests[688].

However, he asserts that the development of FATF standards lacked inclusive participation of developing countries and did not serve their interests[689]. He argues that in the latter scenario, where states see the rules and standards as externally imposed and contrary to their interests so that they are unwilling to comply with them, the policy makers (the FATF in this case) could either force the unwilling countries to comply or provide inducements /incentives to do so[690]. Lastly, policy-makers can try and persuade such countries that compliance is the "right thing to do"[691]. The discursive 'problematisation' strategy used by the FATF, according to Hülsse, was to portray the "problem of money laundering" as a global phenomenon that is not limited to the FATF countries[692]. Just as crime takes place in all countries and trans-nationally, the systems through which the proceeds of crime can be laundered operate throughout the globe via the interconnected global financial system.

[686] H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178, p.156.
[687] *Ibid.* 158.
[688] *Ibid.*
[689] *Ibid.*
[690] *Ibid.*
[691] *Ibid.*
[692] *Ibid.* p.169.

The second discursive FATF strategy that Hülsse describes was a claim that money laundering was not only a global phenomenon, but also a ‘global problem’[693]. The FATF, according to Hülsse, achieved this through rhetoric in most of its communiqués and annual reports where the term ‘money laundering’ did not stand on its own, but was qualified by the word ‘problem’[694]. ‘Money laundering’ was proclaimed as a ‘money laundering problem’[695]. Another rhetorical technique was to ‘objectify’ the ‘money laundering problem’ through ‘awareness raising’ in countries beyond the OECD or FATF membership[696]. This was to say that those countries that had not complied with its standards were depicted as naive and as disregarding the risks of money laundering for their economies and the international financial system.

The last rhetorical technique of the FATF that Hülsse identifies is the characterization of money laundering as something of a meta-crime[697]. With this technique, money laundering is not just a crime, but a threat to democracy, economy, financial stability and security - especially after the 9/11 incident. Lack of or refusal to comply with standards aimed to combat it was, by means of this technique, generally interpreted by the FATF as support for organised crime. The FATF would therefore warn non-compliant states and territories that lack of compliance could have a dampening effect on their development and foreign direct investment, thus threatening their economic growth.[698] Having persuaded its targets that money laundering was a global phenomenon and its nature highly problematic, the FATF then moved to further convince them that only global harmonisation of rules under its leadership would solve the problem[699].

As a result, any country that incorporated the FATF standards because they believed the regime would address their interests or concerns could be assumed to have adopted the regime voluntarily. However, if there is evidence of undue pressure exerted, such a transfer would no

[693] *Ibid.*
[694] *Ibid.*
[695] *Ibid.*
[696] *Ibid.*
[697] *Ibid.*
[698] *Ibid.* pp.173-4.
[699] *Ibid.*

longer be voluntary, but rather coercive. There appears to be a thin line between voluntary and coercive transfer. Hülsse emphasises the voluntary schemes of policy transfer in respect of the AML regime, especially with respect to developing countries that did not participate in the deliberative rule-making processes of the FATF. However, as stated above, he does not discount that a coercive role was played by the NCCT blacklist programme. According to him, therefore, the FATF primarily used persuasion, which was backed by real threats of coercive economic sanctions.

The work of Sharman[700] is most closely related to my own project as it draws on the policy diffusion literature to examine the spread of the FATF standards throughout the globe. He argues that diffusion of this global regime constituted a clear case of coercive transfer by developing countries. He makes an empirical case of how the regime was adopted in three Island countries. He argues that the adoption of AML measures by these countries was not driven by any rational lesson-drawing, but rather by undue pressure[701]. He also notes the combination of discursive and overtly coercive elements of the NCCT blacklists. These three works by Drezner, Hülsse and Sharman suggest in varying degrees that there were clear coercive strategies used to transfer the FATF standards to developing countries.

The coercive strategies of the FATF challenge the legitimacy of its global regime[702]. All these authors (particularly Drezner and Hülsse) admit that some countries appear to have incorporated the global AML regime voluntarily. This is, however, often because both the coercive and the voluntary schemes of the transfer to developing countries complemented each other. This makes it difficult to ascertain which countries adopted the regime voluntarily. It is also questionable whether the response to economic incentives which accompanied the transfer to some capital-starved countries can truly be considered as voluntary.

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[700] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.
[701] *Ibid.*
[702] See Chapter 8.

Where coercive transfer could be confirmed without doubt is to those countries that were on the initial NCCT blacklists and had to incorporate the FATF standards as a pre-condition for their removal. This included only 27 countries. However, the FATF regime has now spread widely, covering over 170 countries and territories throughout the globe and there are many new cases to consider. South Africa, like many other developing countries, was not blacklisted. This makes it more difficult to determine whether the transfer to South Africa was coercive or voluntary. There is also a very thin line between coercive and voluntary transfer here, because many countries, although not on the NCCT blacklists, had not fully complied with the FATF standards and therefore faced a threat of blacklisting if they did not take corrective action (or what Hülsse refers to as 'pre-emptive compliance'). What conditions and evidence, then, would help us determine whether South Africa's transfer was voluntary or coercive.

For the purpose of this study, a transfer would be coercive when there was external political and/or economic pressure applied or threatened to be applied during the deliberative processes of incorporating the FATF standards to South Africa. There must be evidence of this pressure, backed by political or economic sanctions. The sources of this pressure must be identifiable and, at least, be acknowledged as one of the reasons for South Africa's incorporation of the regime. This means that even if the South African authorities were fairly convinced that the regime best served their country's interests of combating crime and modernizing of their laws (given South Africa's transition from apartheid to democracy), the existence of fear or practical considerations of external sanctions could suggest that South Africa's regime was externally imposed. Absence of any external political or economic pressure used to bring about or justify South Africa's incorporation of the regime would lead to a conclusion that the transfer was voluntary.

The transfer of FATF standards to South Africa

In this last part, we enquire into why and how South Africa incorporated the global regime against money laundering. We also show that there was policy transfer of the global AML regime by adapting Colin Bennett's model[703]. Bennett argues that a proposition that policy adoption in one jurisdiction is attributable to similar actions elsewhere can only be substantiated if it can be demonstrated that:

1. idiosyncratic domestic factors are not independently responsible for the policy adoption;
2. the adoption is not the result of the effects of similar modernizing forces having the same, but separate, effects in different states;
3. Policymakers are aware of the policy adoption elsewhere; and
4. This overseas evidence was utilized within domestic policy debates[704].

Bennett comparatively studied cross-national adoption of ombudsperson agencies and data protection laws. He articulates reasons for the above model. He says that some similarities and timing of policy adoption could be attributed to chance or "perhaps each state in isolation and for independent reasons concluded that these policies should be adopted"[705]. By tracing the history of the AML regime in South Africa, we can show that South Africa's adoption of the regime cannot be accounted for through 'idiosyncratic domestic factors' alone. It could rather be explained through both domestic and external structural factors, including international pressure and the 'problematisation' kind of persuasive discourse that Hülsse referred to. We also show that authorities in South Africa were not only aware of policy developments in the global environment, but were proactively and systematically made aware (of such developments) and used that overseas evidence extensively and with great aplomb in crafting their domestic AML regime.

[703] Bennett, C.J. 1997. Understanding ripple effects: the cross-national adoption of policy instruments for bureaucratic accountability. *Governance: An International Journal of Policy and Administration*, Vol. 10 (3), pp.213-233.
[704] *Ibid.* p.214.
[705] *Ibid.* p.215.

There was also pressure from local policy think tanks or policy entrepreneurs, some with transnational links, in ensuring that the South African lawmakers enacted the regime and did so in a way that conformed with the 'best practice' 'international standards' set by the FATF. These local policy entrepreneurs might have had their own interests, which may not be difficult to see through. Or, rather, they may have perceived or foreseen that the adoption of these standards was inevitable. They may, therefore, have wittingly or unwittingly became the agents of the global players in warning the government of the dangers of non-compliance with the FATF standards and in persuading it to follow suit or face the FATF 'sword'.

The continuous amendments of the AML regime in South Africa have always coincided or reacted to similar policy changes at a global level: from the initial AML laws and regulations to the counter terrorism financing (CTF) measures that were enacted in response to September 11 bombings in the United States. We argue that it is therefore neither chance nor choice that South Africa's regime resembles the requirements of the global AML regime as set by the FATF. There are domestic and external factors to South Africa's incorporation of the FATF standards. The first domestic factor could be gleaned from the preambles of the legislation establishing the regime and could be classified as directed at crime combating. A second domestic factor could be deduced from the country's political transition from apartheid to democracy which took place in the early 1990s -- necessitating that South Africa amend old laws or enacts new ones to establish or transform institutions in line with the new democratic constitution and its social realities.

In the 1990s, South Africa could and did independently and legitimately "draw lessons" from other jurisdictions in order to deal with its social problems or to modernize its apartheid inherited laws and institutions. But could South Africa's adoption of the global AML/CFT regime be explained by simply referring to these circumstances at home? The answer to this is No. These conditions created incentives to borrow but do not demonstrate that it actually occurred. There are a number of other external factors that influenced South Africa's incorporation of the FATF standards. In fact, the first legislation in South Africa's AML regime was the *Drugs and Drug*

Trafficking Act of 1992, which created offences of drug-related money laundering. However this law was enacted by the outgoing apartheid regime, suggesting that there was an awareness of the existence of the Vienna Convention prior to democratic transition even though the apartheid government was banned from any participation in the UN due to international anti-apartheid sanctions.

Jordaan[706] wrote that the contents of the *Drugs and Drug Trafficking Act* 1992 and *Proceeds of Crime Act of 1996* were strongly influenced by the UK's *Drug Trafficking Act* of 1986. The *Proceeds of Crime Act of 1996* was passed in the same year with the *International Cooperation in Criminal Matters Act* and the *Extradition Amendment Act*. These laws were passed two years into the democratic government's tenure in office. During the period of their enactment, there was a lot of domestic legislative activity, not only in the area of criminal justice, but also in education, health and other areas where old laws were being amended or repealed. But the timing of the enactment of these two laws suggests that South Africa enacted them in order to accede to the Vienna Convention[707]. The first Minister of Justice for democratic South Africa clearly confirmed this when he told Padraig O'Malley in an interview in 1997 that:

> "South Africa was not in a position to accede to the Vienna Convention on the combating of narcotic drugs and psychotropic substances. It could not because it simply did not have the laws in place and so in our very first two or three years in office we have developed adequate legislation in that regard, got that legislation through parliament and South Africa is now in a position to move forward towards acceding to the Vienna Convention."[708]

[706] Jordaan, L. 2002. Confiscation of the proceeds of crime and the fair-trial rights of an accused person. *South African Journal of Criminal Justice*, Vol. 15.
[707] See also d'Oliviera, J. 2003. International cooperation in criminal matters: the South African contribution. *South African Journal of Criminal Justice*, Vol. 16.
[708] *O'Malley's Interview with Dullar Omar*, 11 March 1997.
http://www.nelsonmandela.org/omalley/index.php/site/q/03lv00017/04lv00344/05lv01092/06lv01102.htm

The laws enacted in 1996 were enacted to ensure, among others, that South Africa was able to accede to the UN Vienna Convention, since the *Drugs and Drug Trafficking Act of 1992* alone was inadequate[709]. It did not provide for adequate international mutual cooperation, extradition or assistance in relation to external matters on areas of extraterritorial confiscation and forfeiture of proceeds of crime (which were confined to drugs then). These three 1996 laws came about following an investigation by the South African Law Reform Commission (SALRC) which started in 1994[710], just before the country's historic democratic post-apartheid election of 1994. SBP's work that we referred to above found that within the Department of Justice, many of the initial processes for legislative changes emanate from research conducted by the SALRC[711]. It is this body that actually proposed the enactment of these laws for South Africa through a research report entitled *International Cooperation in Criminal Prosecutions*[712]. It is important to introduce this body, the SALRC, because a lot of legal policy learning and transfer appears to be facilitated by it within the criminal justice sector.

The SALRC was formed in 1973 by the apartheid government under the *South African Law (Reform) Commission Act 19 of 1973*. The SALRC survived the democratic transition. Its members are legal experts who are appointed by the President of South Africa. The mandate of the SALRC, according to its founding Act[713], is to do research with reference to all branches of the law of the Republic and to study and investigate all such branches in order to make recommendations for their development, improvement, modernization or reform, including:- repeal of obsolete or unnecessary provisions; removal of anomalies; bringing about of uniformity in the law in force in the various parts of the Republic; consolidation or codification of any branch of law; and taking steps aimed at making the common law more readily available.

[709] *Author Interview with Willie Hofmeyr, October 2009*. See also SALC. 1995. *International cooperation in criminal prosecutions*. Project 98: Report, South African Law Commission, Pretoria.
[710] *Ibid.*
[711] See SBP. 2005. *Investigation of the Possibilities for Regulatory Impact Analysis in South Africa*. A Study Prepared for the Presidency and the National Treasury. Executive Summary: Phase 1 to 3. http://www.sbp.org.za/uploads/media/RIA_SBP_project_for_SA_presidency__Treasury_Summary.pdf
[712] See *South African Law Commission's Twenty-Fifth Annual Report 1997*. SALRC, Pretoria
[713] See Section 4 of *South African Law Reform Commission Act* 19 of 1973

The SALRC has played a major role in South Africa's legal developments over the years. It has got research teams/working groups for various fields of law and conducts research and advises the government on legal developments. It proposes new legislation and amendments to existing laws. Some of the new laws it has worked on were those emanating from the provisions of South Africa's new constitution. The legislative proposals the SALRC may go to the extent of drafting Bills that are then subjected to all the stages of law making from a departmental level to the final stages where such Bills become Acts of parliament after being signed by the President[714]. The Minister of Justice and Constitutional Development is the primary and major client of the SALRC and laws on AML policy came through the Ministry's initiatives[715]. The SALRC appears to be a major source of policy learning and transfer as it mainly conducts research at the early phases before such proposals are even referred to the affected departments. In the area of AML laws, it played a major role starting with the passing of the above-mentioned three 1996 Acts which brought South Africa into full compliance with the Vienna Convention.

South Africa acceded to the Vienna Convention in 1998. At this time there was a parallel process at the SALRC, dubbed Project 104, and entitled *Money Laundering and Related Matters*. Three documents were issued by the SALRC for Project 104, namely; Issue Paper No 1[716], Discussion Paper 64[717] and a report[718]. It is important to analyze these documents because they shed some light on South Africa's policy learning and transfer of the global AML standards. The

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714 See earlier discussion on the law making process above.
715 See *South African Law Commission's Twenty-Fifth Annual Report 1997*. SALRC, Pretoria. Anyone can make proposals to the Commission for legislative reform. This includes the executive branch of government. The Commission is made up of legal experts, from judges, attorneys, advocates, academics and researchers. The researchers, who mainly are admitted advocates, attorneys or academics, are full-time employees who conduct research on the various projects of the Commission. The Commission members are not full-time as they are practitioners in various fields mentioned above. The Commission is an independent body accountable to the Minister of Justice and Constitutional Development. Most of the Bills promoted by the Minister of Justice and Constitutional Development have been prior researched by the Commission.
716 SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf
717 SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Discussion Paper 64*, Pretoria. http://www.justice.gov.za/salrc/dpapers/dp64_prj104_1996.pdf
718 SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Report*, Pretoria. http://www.justice.gov.za/salrc/reports/r_prj104_1996aug.pdf

SALRC normally publishes Issue Papers to publicly make its initial proposals for law reform. In these papers it requests the public to make comments and suggestions. After receiving comments on the Issue Papers, it would then compile 'Discussion Documents', which are usually followed by public engagements in the form of workshops and conferences. *Issue Paper No. 1*- entitled *Money Laundering and Related Matters*- was published by the SALRC in March 1996, requesting the public and interested parties to make comments and suggestions on its proposals for the establishment of the financial regulatory measures against money laundering[719].

What came out of this process, we submit, was no longer driven by South Africa's intentions to accede to the Vienna Convention. Instead, *Issue Paper No. 1* seems to have been directed at ensuring South Africa's compliance with a totally private and non-legally mandated regime driven by the FATF and the great powers (G7). However, the SALRC did not disclose this in *Issue Paper No. 1*. Rather, SALRC's intervention suggests that its research and legislative proposals for the financial regulatory measures were mere improvements to South Africa's laws and not responses to external pressure to comply with the FATF standards. The SALRC acknowledged, however, that *Issue Paper No. 1* was compiled in consultation with "a group of diverse experts"[720]. These experts were not named, which made it difficult to discern whether the FATF or those acting to promote its international best practice standards (or agents) were by then involved in the initial stages of the transfer or not[721].

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[719] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf
[720] *Ibid.* p.1.
[721] From the final report (SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Report*, Pretoria. http://www.justice.gov.za/salrc/reports/r_prj104_1996aug.pdf) submitted to the Minister of Justice, only the names of those who responded to the Issue Paper or the Discussion Document were listed. The respondents were; Attorney-General: Cape Town, Attorney-General: Grahamstown, Totalisator Agency Board KwaZulu-Natal, Bond Exchange and Eskom, Centre for Business Law: University of Orange Free State, Coopers & Lybrand, Council of South African banks, South African Reserve Bank (Department of Exchange Control), Development Bank of Southern Africa, Financial Services Board, First National Bank, Johannesburg Stock Exchange (Dr. D Geldenhuys), Law Society of the Cape of Good Hope, Life Offices Association, South Africa Futures Exchange (Prof FR Malan), Office for Serious Economic Offences, Province of KwaZulu-Natal, Provincial Administration: Western Cape, Messrs Rashid Patel & Co, Society of Advocates of South Africa Transvaal Provincial Division, South African Institute of Chartered Accountants, South African Police Service (National Crime Investigation Service and South African Narcotics Bureau), Transvaal Law Society, Mr CL van Heerden, Adv. J Wild: Society of Advocates of Natal.

The SALRC explained in *Issue Paper No. 1* that while South Africa had criminalized money laundering and given the courts powers to issue orders for the confiscation of proceeds of crime, now it was focusing on the "regulatory measures to combat money laundering"[722]. There is no immediate explanation as to why South Africa needed such 'regulatory measures' as it had already criminalized money laundering. Then the report defines money laundering and explains the three stages through which money laundering is believed to occur. These stages include the placement of proceeds of crime into the financial system, distribution or layering and reintegration stages, where funds are returned for use by criminals[723]. *Issue Paper No. 1* then goes on to explain that South Africa's legal framework does not have a regulatory framework to deal with these processes of laundering, except where that money laundering occurs in the context of drug offences (through the *Drugs and Drug Trafficking Act of 1992*)[724]. Then the report abruptly declares that

> "If the principle that laundering of all proceeds of crime should give rise to criminal liability is accepted, it follows that administrative measures to combat money laundering should not only apply in respect of certain offences. The problem with our law is, however, that a comprehensive legislative scheme comprising regulatory measures to combat money laundering is lacking"[725].

It is our view that *Issue Paper No. 1* should have made a stronger case for the necessity of financial regulatory measures for South Africa. It however did not. Instead it loosely claimed that criminals needed the business community in order to launder their proceeds of crime[726]. Because of this claim, it proposed that private businesses needed to be regulated so that they could not be

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[722] SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf p.2.
[723] *Ibid.* p.3
[724] *Ibid.* This is however not accurate since the *Proceeds of Crime Act of 1996* criminalised the laundering of all serious crime.
[725] *Ibid.* p.4.
[726] *Ibid.*

used by criminals in that manner[727]. It further claimed that the establishment of financial regulations would assist law enforcement agencies in identifying, investigating, preventing and prosecuting money laundering[728]. That is the gist and the reasoning of *Issue Paper No.1* which introduced the FATF's financial regulatory regime in South Africa.

Notwithstanding the fact that the report did not give an adequate background to the problem it aimed to address, the main reasons advanced for introducing the regime seemed to lack any justifiable grounds for establishing such a colossal administrative scheme. It is important to emphasize that the introduction of the elaborate AML regulatory provisions on financial institutions and other businesses was not a recommendation of the Vienna Convention. As a result, it can be inferred that the development of these regulatory measures was not informed by South Africa's need to comply with that international convention or any other international legal agreement it might have acceded to. A question might then be asked as to where the researchers of Project 104 at the SALRC got this idea of financial regulatory measures? We ask this question because there are no apparent references in Issue Paper No.1 itself. There are, however, a number of possible entry points for these ideas.

The SALRC appears to have learnt these ideas while researching their previous project on *International Cooperation in Criminal Matters*. Another source appears to have been experts they consulted and/or the legislation of other countries, particularly the US, UK and Australia, where financial regulations on businesses were already in place. Other sources could have been the Commonwealth Secretariat's *Model Law on Prohibition of Money Laundering (1996)* or the FATF's 40 recommendations of 1990. The latter was the first initiative at a global level to recommend that countries regulate their private businesses in order to combat money laundering. There is no evidence of any contact between the SALRC researchers and the FATF at the time of the publication of *Issue Paper No. 1*. However, late in the year (1996), the FATF and the

[727] *Ibid.*
[728] *Ibid.*

Commonwealth hosted the Southern and Eastern African Conference on Money Laundering of 1996 in Cape Town, South Africa[729].

The SALRC then published a discussion document, *Discussion Paper 64*, where it reported that the respondents to *Issue Paper No.1's* call for comments were 'unanimous in their support' for the proposed financial regulatory regime[730]. The important part of this discussion document was that it published a potential draft Bill, with a call for public comments. In August 1996, the final report[731] of Project 104 was submitted to the Minister of Justice and Constitutional Development where the SALRC made known its final views and a Bill that it drafted in revised form and proposed. This final report proposes the introduction of a regulatory regime and the formation of a financial intelligence unit for South Africa[732]. The regulatory framework would require regulated businesses to develop internal rules to combat money laundering, keep records of customer transactions for at least 5 years, appoint anti-money laundering reporting/compliance officers, report suspicious and threshold customer transactions to a financial intelligence unit and, mandatorily train their staff on anti-money laundering duties[733].

In this final report, it appears that the SALRC borrowed all its proposals for South Africa's regime from Australia, the US and/or the UK in that they were virtually identical[734]. The UK and Australia had emulated US laws that were discussed above from 1986 and most of their laws (UK and Australia) had been passed prior to the Vienna Convention and the Financial Action Task Force's 40 Recommendations[735]. The final Project 104 report also, for the first time, made mention

[729] See discussion on this conference later below.
[730] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Discussion Paper 64*, Pretoria. http://www.justice.gov.za/salrc/dpapers/dp64_prj104_1996.pdf, p.5. As with *Issue Paper No. 1*, in *Discussion Paper 64*, the respondents are not named, except for their acknowledgement of "valuable responses". This makes it difficult to ascertain the influences and learning taking place during these phases.
[731] SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Report*, Pretoria. http://www.justice.gov.za/salrc/reports/r_prj104_1996aug.pdf
[732] See *Ibid.*
[733] *Ibid.*
[734] *Ibid.*
[735] As a result, the UK had the *Drugs Trafficking Control Act* in 1986 and the *Criminal Justice Act* in 1988 which were the enabling legislation for the establishment of regulatory measures in the UK in the form of *Money Laundering Regulations* of 1993. The corresponding legislation in Australia was the *Proceeds of Crime Act* of 1987 and the

of the Basel Committee on Banking Supervision and the FATF's "international accepted principles" for regulation of private businesses, especially banks, to justify its recommendations on 'know your customer'[736].

However, the report does not disclose that this whole regulatory scheme it proposed sought to make South Africa compliant with the FATF's 40 Recommendations. Although the final report does not acknowledge the enormous regulatory costs to consumers that would arise from its proposed regulations, it acknowledges the high costs of regulation to government and business but justifies them in the "national interest of the Republic"[737]. According to this report, the regulatory measures would deal with "large scale crime" and would make South Africa's financial system "as unattractive as possible to criminals…protecting the integrity of the business community"[738]. Lastly, the authors of the report mentioned that

> "The Minister of Justice has recently indicated that the matter is regarded as one of some urgency. The surge of foreign investment in recent months in South Africa, and its return to full participation in the international community underscores this fact"[739].

This declaration of "urgency" by the SALRC may suggest that the Minister of Justice may have been advised of such and the government or the Justice Ministry might have already taken a decision to introduce these regulatory measures. Interesting in this message, however, is the link

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Financial Transactions Reports Act of 1988. The UK and Australia had emulated US laws that were discussed above from 1986 and most of their laws (UK and Australia) had been passed prior to the Vienna Convention of 1988 and the Financial Action Task Force 40 Recommendations of 1990

[736] See SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Report*, Pretoria. http://www.justice.gov.za/salrc/reports/r_prj104_1996aug.pdf, p.17. What is striking is that in respect of customer identification, the SALRC steered clear on recommending the verification of customer's addresses (see *Ibid.* p.16-18), a central feature of 'know your customer' provisions. The stricter client identification and verification provisions which lead to unintended and undesirable outcomes of financial exclusion in developing countries (see next Chapter) seem to have emerged later in secondary legislation (FICA regulations), after the FICA had been passed.

[737] SALC. 1996. Money laundering and related matters. South African Law Commission, *Project 104: Issue Paper 1*, Pretoria. http://www.justice.gov.za/salrc/ipapers/ip01_prj104_1996.pdf,p. 8.

[738] *Ibid.*

[739] *Ibid.* p.26.

between South Africa's return to the international community and the alleged urgency of the AML financial regulations. The link is also drawn between foreign investments and the AML regime. Foreign investment continues to be a dear subject to developing countries.

In promoting the AML regulations, the FATF and such organizations as the Basel Committee on Banking Supervision, World Bank and the IMF have always emphasized this regime as essential to economic growth and development as it allegedly protects financial institutions from risks of criminal abuse. If these regulatory measures would help South Africa maintain a stable financial system conducive to foreign investment, the Minister would have correctly emphasised 'some urgency'. However, could there have been some political or economic pressure on South Africa's adoption of the FATF standards as early as 1996 or earlier? This is not clear. There is, however, evidence that the FATF had already started its worldwide campaign to disseminate its standards, even to non-FATF member countries. Its 1996-1997 annual report shows that in 1996 it had sponsored and organised several seminars and conferences for various regions including Russia, Eastern Europe, Turkey, Southern and Eastern Africa, urging countries to adopt its standards[740]. The FATF was until that stage, as Hülsse[741] argues, still on an 'awareness-raising' mission -- trying to persuade non-member countries of the 'money laundering problem' and the existence of its international best practice standards to solve it.

In October 1996 the FATF organized the *Southern and Eastern African Money Laundering Conference,* which was held in Cape Town, South Africa. This is shortly after the final SALRC report was submitted to South Africa's Minister of Justice in August 1996. This conference was co-sponsored by the FAFT and the Commonwealth Secretariat[742]. In its 1996-1997 Annual Report, the FATF noted that;

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[740] See FATF. 1997. *Annual Report 1996-1997*. OECD, Paris, June 1997.
[741] H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.
[742] See FATF. 1997. *Annual Report 1996-1997*. OECD, Paris, June 1997. The Commonwealth Secretariat had published the "The Model Law on Prohibition of Money Laundering and Supporting Documentation of 1996" as a recommended template of the regime that members of the Commonwealth, the mainly former colonies of Britain,

> "Most countries in the [Southern and Eastern Africa] region have not made money laundering a criminal offence nor do they have other anti-money laundering measures in place. Those that do tend to be restricted to drug money laundering, though countries such as Zimbabwe, Tanzania and South Africa (which has already enacted several important pieces of legislation) are further advanced. An encouraging development though was the holding of a Southern and Eastern African Money Laundering Conference…Most of the countries in the region attended and expressed a willingness to develop a unified approach to dealing with anti-money laundering issues in the region"[743].

Government representatives from 13 countries[744] of Southern and Eastern Africa, including South Africa, attended the conference, together with the following representatives from FATF 'sponsoring countries': Canada, France, Italy, Portugal, United Kingdom and the United States. It is in this conference where a proposal was adopted, "subject to confirmation by heads of government" of the Southern and Eastern Africa states, to establish a Southern and Eastern Africa FATF[745]. At this time, the FATF was on a world-wide charm offensive. Having managed to encourage 'willingness to develop a unified approach in dealing with anti-money laundering issues in the region'[746], its awareness raising crusade was already bearing fruit.

There were also developments on the side of transnational policy communities. The Centre for the Study of Economic Crime, based at the University of Johannesburg (former Rand Afrikaans University), in conjunction with the Centre for International Documentation on Organised and Economic Crime of Cambridge University (UK) and the Centre for International Financial Crime Studies of the University of Florida (USA), had organized the "first academic symposia on South

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were expected to develop within their jurisdictions. South Africa was readmitted into the Commonwealth after its democratic transition of 1994.

743 *Ibid.* p.12

744 *Ibid.* Representatives from Botswana, Kenya, Malawi, Mauritius, Namibia, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe and South Africa attended.

745 *Ibid.*

746 *Ibid.*

African money laundering laws" that was held in 1997 at the University of Cambridge's Jesus College in the UK[747]. A number of senior government officials from South Africa, academics and experts attended the symposium. It becomes clear from the speech made by Adv. Selby Baqwa, South Africa's then Public Protector that the South African authorities had become aware of the FATF standards and regarded their adoption as necessary.

For instance, Adv. Selby Baqwa mentioned, citing the FATF/Commonwealth funded conference that had been held in Cape Town the previous year, that

> "The 40 Recommendations of the Financial Action Task Force on Money Laundering have become the internationally accepted standard against which the implementation of anti-money laundering measures is assessed"[748].

Referring to the same conference with regards to a resolution to form the Southern and Eastern Africa FATF-style regional body and the recommendations that such a body should adopt the FATF's 40 Recommendations, Baqwa mentioned that

> "The South African Government was requested to promote the process that will eventually lead to [the] formation of such a body. In reaction to this request the South African Government has bestowed the responsibility for this process, together with the implementation of an anti-money laundering policy for South Africa, on the Department of Finance which is currently continuing with the preparations to get this initiative off the ground"[749].

There is no doubt that at that time the FATF was already directly involved in the policy transfer process, not only in South Africa, but in the whole of Southern and Eastern Africa region

[747] *FIC Bill: Briefing*, 20 March 2001, Parliamentary Monitoring Group, Cape Town.
[748] See Address by Adv. Selby Baqwa, Public Protector of the Republic of South Africa: *Money Laundering- Regional Cooperation in Southern Africa*, At the Fifteenth International Symposium on Economic Crime, At Jesus College, Cambridge, 20 September 1997.
[749] *Ibid.*

judging by the number of countries that attended its conference in Cape Town. It appears also from Baqwa's comments above that South Africa was earmarked to play a leadership role in the process of disseminating the FATF standards to its neighbours. After the final SALRC report had been submitted to the Minister of Justice, it was referred to the Ministry of Finance, which was to be the custodian of South Africa's financial regulatory regime against money laundering[750]. The location of the regime within the Ministry of Finance seems to follow an international trend, as most countries have generally located their financial regulatory schemes under finance ministries, although they also pertain to the administration of justice. Some countries have, however, placed their FIUs under law enforcement agencies (i.e. the UK) or justice departments.

There was a long delay (five years) before the SALRC recommendations were introduced to the South African Parliament and became an Act of Parliament in 2001[751]. The Financial Intelligence Centre Act (FICA) of 2001 was passed after a long process at the Department of Finance, which culminated in the redrafting of the Financial Intelligence Centre Bill by a task team appointed by the then Minister of Finance, Trevor Manuel[752]. The task team consulted the industries that would be affected by the regulations[753]. A redrafted Bill was then submitted to the Ministers of Finance and Justice for discussion, more refinements and further consultations with 'key departments and agencies as directed by Cabinet, before approval in 2000'[754]. The Department of Finance appears to have had some reservations with the legislation as proposed by SALRC. However it is not clear what these reservations might have been. At the briefing of the

[750] *South African Law Commission's Twenty-Fifth Annual Report 1997*. SALRC, Pretoria.

[751] The delay in the making of this FICA appears to have been some technical differences between the SALRC proposals and the Ministry of Finance. The Deputy Minister of Finance, Dr. Mandiswe Mphahlwa, in the first introduction and briefing of the Bill in parliament on 20 March 2001 explained that the Ministry of Finance wanted to "ensure that legislation is appropriate to the South African circumstances", although the Task Team ended up supporting the SALRC recommendations. The SALRC, on the other hand, appears not to have consulted with the Department of Finance in developing the regulatory framework, despite the role that the Department was to play as the custodian of the regime for the country.

[752] See *FIC Bill Briefing*, 20 March 2001, Parliamentary Monitoring Group, Cape Town. See also De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime. Rand Afrikaans University: Johannesburg, p.20.

[753] See *FIC Bill Briefing*, 20 March 2001, Parliamentary Monitoring Group, Cape Town.

[754] *Ibid.*

introduction of the FIC Bill to parliament, the Deputy Minister of Finance then, Dr. Mandisi Mphahlwa, explained that the differences between the Department of Finance and SALRC appeared to have been 'technical' and that the Finance Ministry's concern was in ensuring that the legislation was "appropriate to the South African circumstances"[755].

Looking at the Bill proposed by the SALRC in 1996 and the Bill that was redrafted by the Department of Finance, there appears to have been no substantial differences. All the regulatory measures suggested were carried through in the final Bill that was introduced to parliament in 2001 for the parliamentary legislative process. However, while there was this deliberation on the FIC Bill at the Department of Finance, a number of parallel AML policy developments were taking place. *The Prevention of Organised Crime Act of 1998* was quickly developed and passed by parliament. The development of the POCA could have been unexpected and a surprise given the fact that there was already the *Proceeds of Crime Act of 1996* which dealt with almost the same issues of asset forfeiture of proceeds of crime. The National Prosecuting Authority was also established, housing the Asset Forfeiture Unit and the Directorate of Special Operations.

In 2001, Pieter Smit, the principal investigator on the SALRC's Project 104 on *Money Laundering and Related Matters*, wrote a monograph which was published in January, just before the parliamentary processes on the FIC Bill resumed in March that year. The monograph was published by the Institute of Security Studies, a 'think-tank' based in South Africa and an influential player in the making of anti-organized crime legislation and policies. Smit, in this monograph, warns that while South African law had created very broad money laundering and asset confiscation and forfeiture regimes, its law was

> "…lacking with regards to administrative money laundering control measures. South Africa's current provisions fall short of the international standards set by the 40 recommendations of the Financial Action Task Force. It is hoped that the

[755] *Ibid.*

> enactment of the Financial Intelligence Centre Bill will go some way to address this shortcoming."[756]

This would seem to have been the first instance that someone involved in the SALRC project 104 made published comments about South Africa's needs to comply with the global FATF standards. This suggests that despite South Africa's need for this regulatory framework, as applied in other countries that South Africa (or the SALRC specifically) drew lessons from, there was some international political pressure to comply explicitly with the FATF framework. Some of this pressure is mirrored in the oral and written presentations made to the joint parliamentary portfolio committees of the NA and NCOP's public hearings on the FIC Bill. The Life Offices' Association (LOA), in its submission, mentioned that

> "There is an urgency to place money laundering control legislation on the statute book in South Africa. We have the sword of the FATF hanging over our heads and the patience of the international community is reaching its end. We believe that the issue of the non-cooperative countries listed by the FATF will be addressed by other parties in their submissions. At this stage it is sufficient to note the existence of this blacklist."[757]

The LOA was correct. The FATF had started publishing a blacklist of a number of countries in 2000 and 2001; arbitrarily naming and shaming them for non-compliance with its standards. Presenting in the parliamentary public hearings, the Centre for the Study of Economic Crime (CenSEC) emphasised the dangers that South Africa was facing if not compliant with the FATF's standards. CenSEC's oral and written submission concentrated on the urgency of South Africa to comply with the FATF recommendations.

[756] Smit, P. (2001). *Clean Money, Suspect Source: Turning Organised Crime Against Itself*. Pretoria: Institute of Security Studies, Vol. 51, p. 55.
[757] See *FIC Bill Public Hearings*, 23 March 2001, Parliamentary Monitoring Group, Cape Town.

> "It is submitted that the Bill [FIC Bill] should be more consciously compliant with the Forty Recommendations of the international Financial Action Task Force…The FATF is currently the most important international body which specializes solely in combating money laundering"[758]

There was also pressure on parliamentarians to consider the negative implications for the country if they did not fully implement the FATF Recommendations.

> "The major financial centre countries of Europe, North America and Asia are members of the FATF and have adopted the Forty Recommendations as a standard for effective money laundering control strategy. They are required by Recommendation 22 to treat all transactions with parties in countries that do not apply, or insufficiently apply, the Forty Recommendations with circumspection. South African businesses therefore find that their transactions are scrutinized by the major financial centres, because South Africa has not implemented the Forty Recommendations in full."[759]

Some members of the parliamentary portfolio committee might have heard of the FATF for the first time that day. With this submission from LOA and CenSEC, parliamentarians could barely ignore the warnings. South Africa's pace and level of compliance with the FATF recommendations was already compromising and probably delaying South African international business transactions, as claimed by CenSEC above. While the parliamentary committee questioned almost all the submissions of other interested parties during the oral presentations, CenSEC's appears not to have solicited any scrutiny. For instance, CenSEC provided no evidence

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[758] See *Ibid.*

[759] *Ibid.* (emphasis added) The submission carries on to explain that:
"In 1998 the FATF launched a project to identify non-cooperative countries and territories in the international fight against money laundering. A report was published in June 2000. This report listed a number of countries and territories and international pressure was applied to ensure that these countries improved their money laundering control systems. The identification and listing process will continue and, until the FIC Bill has been enacted and the legislation is enforced effectively, South Africa will be in danger of being listed as non-cooperative."

for the statement that "South African businesses therefore find that their transactions are scrutinized by the major financial centres" due to South Africa's non-compliance with FATF standards.

Most of the recommendations made by CenSEC, in respect to the Bill's contents, were justified on the basis that CenSEC's recommendations would make South Africa's regime more compliant with the 'international standards' or 'best practices' of the FATF[760]. CenSEC itself boasts of a colourful profile with links to international anti-money laundering experts in the UK and the US[761]. Even before the passing of FICA, CenSEC appears to have been forward looking, anticipating the unstoppable arrival of the FATF's regulatory regime. It had established a university qualification, a "Certificate Programme in Money Laundering Control to train compliance officers and risk managers in the corporate environment", with "the first 16 graduates having graduated at the end of 2000" and "a further 40 students…by the end of 2001"[762]. It further adds in its profile that

> "These students will be able to play a leading role in the drafting and implementation of compliance policies regarding money laundering in their respective companies"[763].

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[760] See *Ibid.*

[761] In introducing CenSEC, its director (then), Prof Louis De Koker wrote that "The Centre for the Study of Economic Crime of the Rand Afrikaans University has studied measures against money laundering for some time. Personnel of the Centre participated in the drafting of the current money laundering provisions of the Prevention of Organised Crime Act 121 of 1998. Personnel of the Centre also co-operated with Business Against Crime and the Commercial Branch of the South African Police Service in the development of a training programme on money laundering control for investigators of financial crime.
During the course of 2000 the Centre developed a Certificate Programme on Money Laundering Control to train primarily compliance officers and risk managers in the corporate environment. The first 16 students graduated at the end of 2000. A further 40 students completed the course by end of 2001. These students will be able to play a leading role in the drafting and implementation of compliance policies regarding money laundering in their respective companies.
The Centre also co-operates with a number of international role players in money laundering control, including the Centre for International Documentation on Organised and Economic Crime (Cambridge UK) and the Centre for International Financial Crime Studies (University of Florida, USA). These relationships have resulted in a number of publications and symposia, including the first academic symposium on South African money laundering laws that was held in Cambridge, UK, in 1997".

[762] See *FIC Bill Public Hearings*, 23 March 2001, Parliamentary Monitoring Group, Cape Town.

[763] See *Ibid.*

CenSEC has got quite a good reputation within the banking industry in South Africa. We asked a number of compliance officers in various banks what qualifications are required for most of their staff working in the compliance divisions, especially for FICA-related money laundering control duties. The compliance officers confirmed that students coming out of university with professional degrees are hardly aware of the money laundering control regime, since these are recent legal and regulatory developments[764]. However, the 'Certificate in Money Laundering Control' from CenSEC at the University of Johannesburg was the main academic qualification they mentioned as desired, and some as a prerequisite, for their staff working directly in their money laundering control divisions.

This shows that CenSEC was not only forward looking, but has contributed to and reaped some benefits from the introduction of the financial regulatory measures through its academic courses, research, support and promotion of South Africa's compliance with the global FATF standards. CenSEC's submission confirms Adv. Selby Baqwa's assertions, above, that South Africa was assuming a leadership role in the exclusive FATF 'club';

> "No African country is a member of the FATF. As a consequence the Recommendations do not reflect the realities of African economies. There is an expectation that South Africa should be a member of the FATF to ensure that the standards that are set reflect the unique features of its economy and infrastructure as well as that of African countries in general. However, South Africa will also find it difficult to take up membership of the FATF if it is not adequately compliant"[765]

What this highlights is that in order for South Africa to participate in the FATF, it had to first comply with its standards. Ultimately, this expectation was fulfilled when South Africa underwent FATF's mutual evaluation program in 2003 and was invited to become a full-member of the club, joining Brazil and Mexico as the only developing countries in the FATF, later followed

[764] *Author Interviews with Compliance Officers of four banks in South Africa*, *October 2009*.
[765] See *FIC Bill Public Hearings*, 23 March 2001, Parliamentary Monitoring Group, Cape Town

by India and China. Before 2000, the FATF exercised some restraint, and continues to, in including developing countries as members and thus shapers of its standards. It had merely treated them as regulation-takers. When they had been convinced or forced to adopt the regime, they were then very selectively admitted as members, creating a very unbalanced membership between developing and developed countries in the FATF.

Instead, the FATF seem to have been inclined to incentivize the formation of regionally based FATF-style regional bodies (abbreviated as FSRBs). These FSRBs appear to play no meaningful role in shaping the global AML regime. Instead they play a role of encouraging the dissemination and implementation of the FATF standards by those countries that are not its full members[766]. For instance, while many countries in the Caribbean and other small offshore jurisdictions belonged to an FSRB since 1992[767], some of them were unilaterally blacklisted by the FATF in 2000 and 2001 and being members of the Caribbean FSRB did not shield them from the NCCT blacklists.

FICA came into force in South Africa in 2002. In the same year, the former Minister of Finance, Trevor Manuel, convened the inaugural meeting of the Anti-Money Laundering Advisory Council (AMLAC). AMLAC is one of the two institutions established by FICA, the second one being the Financial Intelligence Centre itself. In this meeting, it becomes clearer that political and economic pressure played a deciding role in South Africa's final domestic adoption of FATF standards. In this inaugural meeting Manuel announced that;

> "The formation of the Council [AMLAC] creates a further opportunity to enable us to better manage our country's financial resources- and sends out a strong message that crime does not pay in our country. All of this happens in the context in which people should be encouraged to go about the business of investing their savings and funds – into banks or any other institution…However, there are also certain

[766] See Chapter 8 for more discussion on this.
[767] *Ibid.* for more discussion on the Caribbean FSRB.

> obligations which go with this right. These obligations require that those responsible for managing the system also comply with accepted standards, such as those of the Financial Action Task Force and the Basel Committee. These standards are becoming increasingly global in their scale and scope. We need to accept these, adapt them to our circumstances, and work with, or we will find that they are imposed on us."[768]

The Minister had even bought into the rhetoric of the FATF of negatively labelling offshore financial centres as money laundering and regulatory havens. To that end, he said

> "In the past there have been some countries which have allowed banking and other financial activities to take place with no questions asked…There have also been some other blips in this ocean, small islands mainly which have sought to attract investment through becoming tax havens. They too have not survived as viable sustainable economies."[769]

These statements by the South Africa's former Minister of Finance sum up clearly that South Africa's compliance, particularly with the regulatory recommendations of the FATF, was aimed at avoiding them being 'imposed on' South Africa. The small Islands and other developing countries certainly did not escape the wrath of the FATF and South Africa could not be allowed to follow that route. In his study Sharman[770] shows how smaller defenseless countries whose sole niche had been to provide financial services were negatively affected by the FATF's NCCT blacklists. The admission by Trevor Manuel clearly points to a coercive policy transfer. For a Minister of Finance of a democratic sovereign state to say that his country needs to adopt laws "or we will find that they are imposed on us**"**, as quoted above, seem far from keeping with voluntary

[768] *Statement by the Minister of Finance, Trevor Manuel, MP, at the inaugural meeting of the Money Laundering Advisory Council*. 18 October 2002.
[769] *Ibid.*
[770] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), 635-656.

policy learning. We can therefore safely conclude that South Africa capitulated and incorporated the regime out of fear of possible imposition of sanctions by the FATF, especially on the back of its NCCT blacklists programme. Coercive transfer, according to policy transfer theorists, happens in two ways; directly or indirectly. When it happens directly, a country is forced to adopt particular policies it might not want to[771]. Indirect coercive transfer[772] could take place through persuasion, incentives or sanctions.

It is however our view that South Africa was eventually going to adopt the FATF standards, but that the NCCT blacklists facilitated its ultimate decision to incorporate them, especially at the time it did. This is a clear case of what Hülsse has referred to as 'pre-emptive compliance'[773]. South Africa's incorporation of the regime could therefore be viewed as indirect coercive transfer as it complied with the FATF standards in order to avoid being sanctioned. It is important to also acknowledge that while South Africa adopted the FATF features of the global AML regime under duress, it seems to have adopted the UN Vienna Convention features of the regime through a continuous process of voluntary lesson-drawing and out of its international legal obligations as a member of the UN. To support the latter point, it is important to look briefly at the processes of the making of the POCA of 1998, which was passed besides South Africa having enacted the *Proceeds of Crime Act of 1996*. What, then, was the problem with the *Proceeds of Crime Act of 1996*, which led to a speedy enactment of POCA before even the former legislation had been put to use?

In the introduction of the POCA Bill to parliament, developed countries were used as an example that South Africa should emulate in fighting its organized crime. Peter Gastrow of the Institute for Security Studies told parliamentarians of the Joint Committee of the NA's Justice and Constitutional Development and the NCOPs Security and Justice that South Africa's POCA Bill

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[771] Evans, M. 2009. 'Policy transfer in critical perspective.' *Policy Studies*, Vol. 30 (3), pp.243-268
[772] *Ibid.*
[773] Hülsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.

went “a long way in catching up with countries like the US”[774]. In the development of POCA, South Africa was learning from the US, particularly its RICO statutes enacted as part of the *Organised Crime Control Act of 1970*. We have discussed the substantive contents of POCA in Chapter 4 and the development South African jurisprudence emanating from its enactment. However it is important to make some observations on the making of POCA and the actors that played a major role in bringing about its parliamentary passage.

The making of POCA arises from the *Proceeds of Crime Act of 1996* which had been developed by the SALRC. While the *Proceeds of Crime Act* was based on the UK legislation, the South African authorities were of the view that it was a non-starter in dealing with organized crime[775]. It criminalized the proceeds of crime beyond drugs, an international trend after the FATF had suggested that not only drug money could be laundered, but proceeds of any crime from tax evasion, fraud and other profit driven crimes[776]. This was a new development globally because the Vienna Convention had only required UN members to criminalize the proceeds of drugs[777]. The FATF had started with drugs but in 1996, it amended its standards to include proceeds of all crime[778]. In an interview with O’Malley[779], Willie Hofmeyr, the head of Asset Forfeiture Unit of South Africa, explained that after inheriting ‘old bad laws’ from the apartheid government, the new government started learning from other democratic governments from around the world on how they were dealing with organized crime. This learning was not only confined to organized crime, but criminal law in general in areas such as bail and sentencing legislation[780]. When it came to crime, according to Hofmeyr, parliament had realized

[774] *Prevention of Organised Crime Bill: Briefing* 6 August 1998, Parliamentary Monitoring Group, Cape Town.
[775] *Author Interview with Willie Hofmeyr, October 2009*.
[776] See FATF. 1997. *Annual Report 1996-1997*. OECD, Paris, June 1997.
[777] US laws, as discussed elsewhere above, already covered offences beyond drugs, particularly tax evasion, since the early seventies.
[778] See FATF. 1997. *Annual Report 1996-1997*. OECD, Paris, June 1997.
[779] *Padraig O’Malley’s Interview with Willie Hofmeyr,* 08 August 1998. http://www.nelsonmandela.org/omalley/index.php/site/q/03lv00017/04lv00344/05lv01183/06lv01224.htm
[780] *Ibid.*

> "…that in many democratic countries, crime is a real and a big problem and democracies have had to find ways, and fairly drastic ways, very often, to deal with crime and they've tried to do it in a way that fits in with a rights culture. What we started realising is: we have none of that. We had the bad old laws but because things were relatively easy for the police[781] no attempts had been made to keep up with more sophisticated powers that you can give your police and prosecutors that are consonant with a rights culture. We think that's the sort of thing that we've been looking at…"[782]

In this he was referring, in terms of organized crime, to

> "…the civil forfeiture of criminal assets as well as stuff based on the (RICO) legislation in the [United] States, the racketeering legislation…"[783]

The *Proceeds of Crime Act of 1996* only allowed for criminal forfeiture of the proceeds of crime. This meant that someone had to be found guilty of an offence before their assets could be confiscated or forfeit. The South African authorities became interested in civil forfeiture which was not provided for in the *Proceeds of Crime Act*. In late 1996, a proposal was put to the Minister of Justice to look at putting together a government task team to explore introducing civil forfeiture into South Africa's proceeds of crime legislation[784]. This was initiated by prominent ANC members of parliament, among them, Willie Hofmeyr, then a member of the National Assembly's Justice and Constitutional Development Committee, and Adv. Johnny de Lange, the chairperson of the same committee at the time[785].

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[781] By the police "having it easy", Hofmeyr was referring to the apartheid era tactics where most crimes were solved through torture and securing forced confessions.
[782] *Padraig O'Malley's Interview with Willie Hofmeyr,* 08 August 1998. http://www.nelsonmandela.org/omalley/index.php/site/q/03lv00017/04lv00344/05lv01183/06lv01224.htm
[783] *Ibid.*
[784] *Author Interview with Willie Hofmeyr, October 2009*.
[785] *Ibid.*

In 1997 there was a study tour to the US and Canada to study those countries' civil forfeiture laws and practices[786]. This process resulted in the drafting of *Prevention of Organised Crime Bill*, which was introduced to Parliament in August 1998[787]. The task team consisted of experts, government bureaucrats, academics and private consultants[788]. Among the members of this task team was Peter Gastrow of the Institute for Security Studies- a think tank based in Pretoria that had around the same time commissioned and published some early research studies on organized crime and money laundering and Adv. Pieter Smit, who had been the principal investigator for the SALRC's Project 104 on *Money Laundering and Related Matters*. CenSEC drafted the money laundering provisions of POCA[789].

POCA was therefore initiated by parliamentarians because there was a belief that the *Proceeds of Crime Act of 1996* did not go far enough as far as seizing and confiscating proceeds of crime was concerned. There was also a view that it did not go far enough in tackling South Africa's organized crime phenomenon; particularly gang crime in Cape Town and surrounding areas. Hence racketeering provisions were introduced in POCA. This means that while the SALRC learnt from abroad in developing the *Proceeds of Crime Act of 1996*, it probably did not draw comparisons from jurisdictions with tougher laws on organized crime- such as the US- and POCA was enacted to rectify this. The *Proceeds of Crime Act* was founded mainly on UK legislation which then focused on conviction-based asset forfeiture. According to Willie Hofmeyr, South Africa found the US provisions appealing mainly because they provided for a non-conviction-based civil forfeiture of instrumentalities and proceeds of crime[790].

The making of POCA would appear, therefore, to have been an outcome of a rational and voluntary policy learning/transfer. There appears to have been no undue external pressure put on South Africa to enact POCA. If South Africa had decided not to enact POCA (as it already

[786] *Ibid.*
[787] *Ibid.*
[788] See *Prevention of Organised Crime Bill: Briefing.* 6 August 1998. Parliamentary Monitoring Group, Cape Town.
[789] *FIC Bill Public Hearings*, 23 March 2001, Parliamentary Monitoring Group, Cape Town.
[790] *Author Interview with Willie Hofmeyr*, 26 October 2009.

complied with the Vienna Convention of 1988), it would not have faced a blacklist from the UN or the FATF, as would be the case when it had not enacted FICA. Not many countries use the non-conviction based asset forfeiture system and it is only recently that the FATF and the UN have encouraged countries to make use of this system. There is other legislation that forms part of the global AML regime in South Africa besides the FICA and POCA. The most important one is the POCDATARA of 2004 which was enacted in response to the FATF's extension of its 40+9 special recommendations against terrorism. POCDATARA was, among others, propelled by pressure for South Africa to comply with the FATF standards which had been amended in the wake of US terrorist attacks of 9/11. There were, however, also other incidents of urban-terrorism in the Cape and in Gauteng, which were attributed to a group of Afrikaners (known as the Boeremag) that resented the democratic dispensation. However these local terrorist groups appeared to have no links with international terrorist networks such as Al Qaeda, which POCDATARA was designed for, and were easily arrested by the local police.

Conclusion

South Africa's incorporation of the global AML regime shows that some features, particularly those emanating from the FATF were adopted primarily through coercion. While South Africa was eventually going to adopt them (the FATF's financial regulatory standards) through a voluntary process of lesson-drawing, as the SALRC had proposed in its Project 104, the pressure mounted by the FATF through its NCCT blacklists played the deciding role in the country's adoption of the FATF standards of financial regulation. The adoption by South Africa, and many other developing countries so coerced, or the dissemination of these standards through coercive means, has implications for the global AML regime's legitimacy. This is especially so given that the FATF standards were masked as voluntary and thus, non-legally binding. In the following chapter we examine whether South Africa's forced adoption of the FATF's financial regulatory measures impacted negatively or had any undesirable and unintended consequences on the country's implementation of the regime. We shall also establish whether such negative policy outcomes were caused by or had any correlation with the manner in which the FATF standards were incorporated in South Africa or were generally disseminated to the developing world.

Chapter 6

Implementation: FATF standards in the South African banking sector

Introduction

This chapter examines the implementation of the FATF standards within the financial sector in South Africa. The focus is on implementation and compliance within the retail banking sector. It uses data from various secondary and primary sources such as confidential interviews with AML/CTF compliance officers, regulatory supervisors, law enforcement officers and experts in South Africa. We ask whether South Africa, as a developing country with many structural socio-economic limitations, could fully implement the FATF standards within the financial banking sector, in the manner in which they were initially enacted and if so would this serve South Africa's public interests (for which they were allegedly adopted). Would this facilitate the detection of crime and protection of the soundness of its financial institutions? Private interest theories of regulation argue that regulation comes about as a result of narrow private interests. If such narrow interests ever coincide or end up serving the publicly interested goals, this is mere coincidence. In the implementation of South Africa's AML standards, we notice that they conflicted with other socio-economic policies and instead of combating money laundering, they could deflect crime by excluding large sectors of the population, forcing them into the informal and unregulated sectors of the economy which are difficult to monitor for anti-money laundering purposes.

The implementation and compliance with the FATF standards in many countries, both developed and developing, has encountered some practical implementation challenges. This study developed from an earlier one by this researcher on the implementation of the AML regime in the United Kingdom[791]. In that study, we found among other things, that a variety of regulated

[791] Hlophe, Z. 2004. *Assessing the effects of anti-money laundering regulations in the UK: Suspicious Transaction Reports and their effect in detecting money laundering*. Unpublished MSc Dissertation. University of Leicester, UK.

businesses, particularly banks, faced some real compliance dilemmas when it came to re-identifying and verifying customers in line with the Know Your Customer (KYC) requirements of the FATF standards which had been made law in the UK following the second EU Money Laundering Directive[792]. Some banks, struggling to comply with the KYC requirements, were sending letters threatening to freeze their customers' bank accounts, unless these customers showed up to prove that they were who they claimed to be.

These obviously baffled customers would prove themselves by producing proof of identity and address documents to the nearest branches of their banks[793]. Proof of address seemed not to be a major problem in the UK. Many UK residents, like others in developed countries, could manage to provide a telephone or mobile phone bill or any letter received at their home address in order to prove their residential addresses or satisfy the KYC requirements. Most of the problems were just miscommunication and confusion as to why banks suddenly required customers who had banked with them for many years to prove , under threat of having their accounts frozen, that they were who they said they were. Banks were merely trying to comply with the anti-money laundering regulations aimed at assisting law enforcement agencies to trace customers in case they were involved in laundering proceeds of crime or financing terrorist activities.

Another main challenge, mentioned earlier, was that in the UK there is no standard identity card or document. Some citizens could have passports or driving licenses, both of which were accepted as proof of identity. However, many UK citizens might not have a passport or a driver's license since these documents were basically travel documents[794]. It was and still is highly possible for a person in the UK not to have both of these and therefore struggle to prove him or herself to be who they claim to be, especially for those who do not plan to travel outside the UK or to drive

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[792] *Ibid*. p.24.
[793] *Ibid.*
[794] See De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime* **13**(1): 26-50.

a car. The UK authorities showed some flexibility in drafting their regulations and allowed people to submit a letter from a municipal councillor or other recognised authority as proof of residence. The UK is a well-developed jurisdiction, with no informal settlements and an advanced postal system that reaches almost every household, including small rural villages.

The question then was how similar AML regulations would impact on developing countries, with sprawling informal settlements, limited postal services, ambiguous and confusing addresses and other obstacles to documentary proof of residence. Would banks refuse to open accounts for them, or would those who already have them have their accounts frozen? South Africa had implemented regulations similar to those of the UK through the *Financial Intelligence Centre Act of 2001* (FICA) and the *Anti-Money Laundering Control Regulations (AMLCRs) of 2002*. These required customers of banks to prove their identity and addresses as a way of proving they were who they claimed to be. At the turn of the millennium, as discussed in the previous chapter, the FATF had started to blacklist what it called Non-Cooperating Countries and Territories (NCCTs); forcing many developing countries to adopt its AML standards.

These standards were revised after the 9/11 terrorist attacks in the US and became the FATF's 40+9 *Recommendations against Money Laundering and Counter Terrorist Financing* (AML/CTF). Like many other countries, South Africa moved swiftly to enact the AML/CTF regime demanded by the FATF to pre-empt being blacklisted as that was believed to have negative economic consequences, especially for foreign investment. It passed the FICA and the *Anti-Money Laundering Control Regulations (AMLCRs) of 2002*. Among other things (see below) FICA and AMLCRs provided for Know Your Customer/Customer Due Diligence identification and verification requirements as in the UK, US, Australia and many other countries implementing the regime. South Africa was one of the first few developing countries to adopt the FATF standards of financial regulation, borrowing heavily, as shown in *Chapter 5*, from the UK, US and Australian models. While this regime was adopted for crime detection and combating purposes, it is important to emphasise that it was also incorporated in order to enable South Africa to comply with the 'global standards' as set by the FATF.

The questions that are tackled in this chapter are:

1. To what extent and how were the FATF standards implemented in South Africa?

2. What were the experiences with implementation and compliance within the banking sector in South Africa?

3. Could/should South Africa, given its socio-economic conditions of underdevelopment, fully implement the FATF standards it enacted in 2001?

Our analysis here contributes to the growing literature on the topic of AML/CTF implementation and compliance in developing countries. It tells a story of South Africa's implementation in more detail, focussing on the forces that shaped this increasing recognition of the challenges encountered by developing countries in trying to comply with the FATF standards. It does so in a rich institutionally-contextualised way set against the backdrop of the movement against apartheid and its tentacles in the financial core of the country in the banking industry. In the first part we make some caveats and clarify some concepts. We also briefly acknowledge some key research and findings that have recently been published in the area of AML/CTF implementation in developing countries. Secondly, we examine South Africa's implementation of its AML regime within the banking sector. In this part we show how, at the very early stages, some serious challenges started to emerge, derailing South Africa's 'actual compliance' with the regime. The adoption of the laws (FICA) and regulations (AMLCRs) only produced formal compliance with the regime. Actual compliance, which entails the implementation and enforcement of the enacted regime, is still a work in progress.

The third part looks at a parallel campaign to extend access to financial services for the unbanked South Africans and other residents. In this part we examine how this campaign collided with the implementation of the FATF standards, forcing a rethink of South Africa's implementation of the regime. We examine the role played by a number of players, including the South African government, to try and manage this collision. In this part we also observe how South Africa's challenges in implementing the regime have forced a rethink and may offer some lessons for other developing countries trying to implement the regime under similar socio-economic circumstances. This offers greater opportunities for South-South learning as many developing countries may not have to replicate the mistakes made, but rather can build on the positive lessons. It also shows why developing countries need to be involved as partners in policy development rather than be treated as rule-takers by the powerful Western countries. Finally, we close by making some concluding observations of South Africa's experiences; arguing that developing countries need to be involved at the earliest possible stages of policy development at a global level to avoid the replication of these developing country-specific implementation problems in other policy areas.

In our analysis we seek to explain how and why things turned out the way they did. This approach focuses on the socio-economic conditions of underdevelopment and the political dynamics of South Africa's transition from apartheid to democracy; the time of the country's overarching democratic transformation. We argue that all these dynamics have influenced the implementation and South Africa's compliance with the global FATF standards. We now offer some caveats.

Firstly, this chapter focuses on the implementation and compliance with the rules directed at regulating banks and, later, various private businesses and professions to assist in the detection and combating of money laundering.

Secondly, the focus is on the implementation and compliance with the FATF standards within the financial sector, with an emphasis on the 'banking industry'.

Thirdly, more focus is on those aspects of the AML/CTF regime which, during implementation, have directly conflicted with the wider societal objectives of extending direct access to formal financial services, particularly banking accounts. With these caveats behind us, it is important to acknowledge some developments in this area based on recent research findings.

Some recently published research

There have been a number of new studies that have been published that focus on the 'unintended consequences' of AML/CTF implementation in developing countries. These include recent work done by Prof. L. De Koker in South Africa[795], the Consultative Group to Assist the Poor (CGAP) and the Genesis Analytics study[796], already mentioned in Chapter 1, and that we discuss again towards the end of this chapter. The main findings of these studies have been that stricter KYC requirements can and did have 'unintended and undesirable consequences' of blocking access to, or discouraging the use of, formal financial services in developing countries[797]. The main findings of this study were that developing countries tend to adopt their national AML/CTF financial regulatory regimes based on templates of developed countries[798]. However, the study further finds, when these developing countries start to realise the negative implications of rule-based and strict FATF standards, they have tended to come up with ways of limiting the risks of restricting access to basic financial services through regulatory exemptions[799]. Another key finding, which we prefer to call a recommendation, has been that increased access to financial services in developing countries should be seen as 'complementary in the pursuit of an effective

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[795] De Koker, L. 2008. *Money laundering and terror financing risk management of low risk financial products and services in South Africa: a report prepared for FinMark Trust*. The Centre for Financial Regulation and Inclusion (CENFRI), May 2008. See also Bester, H., de Koker, L., & Hawthorne, R. 2003. *Legislative and regulatory obstacles to mass banking*. FinMark Trust, G:enesis Analytics Pty Ltd, Johannesburg, South Africa.
[796] See G:enesis.2008. *Implementing FATF standards in developing countries and financial inclusion: findings and guidelines.* (authors: Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker), Final Report, February 2008, First Initiative.
[797] *Ibid.* p.vi
[798] G:enesis.2008. *Implementing FATF standards in developing countries and financial inclusion: findings and guidelines.* (authors: Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker), Final Report, February 2008, First Initiative. p. Vi.
[799] *Ibid.*

AML/CTF regime'[800]. According to this logic, the more people access and use the formal regulated financial system, the more far-reaching and effective the AML/CTF regime would be, as less people will be using the informal and unregistered components of the financial system[801].

These findings are an important contribution to the literature and policy development in this area as they have, for the first time, made 'financial inclusion' a fashionable topic even in the FATF circles. Due to developing country problems of financial exclusion wrought by the implementation of KYC regulations, the FATF adopted (in 2008) its first policy towards what it calls 'low capacity countries'[802]. The former FATF president Paul Vlaanderen (2009/10) started his tenure with a visit to Lesotho, where the ESAAMLAG (which is an FATF-style Regional Body or FSRB for Southern and Eastern Africa) was having its 10th Anniversary. In his address he stated that he believed that the pursuit of financial inclusion by developing countries is complementary to an effective AML/CTF regime, as this expands the reach of the regime to more people who would now be using formal financial services[803].

In this assertion he had quoted directly from the Genesis study which asserted that an effective AML/CTF regime should be viewed as complementary to increased access to financial services. However, this depends upon the circumstances prevailing in the particular country. The South African banking sector under which the regime was implemented had for many years been inaccessible and its services unaffordable for many. This encouraged a very limited usage of such formal financial services for many citizens in South Africa, leading to mass campaigns for greater access. This happened around the same time that South Africa was trying to implement the FATF imposed standards of KYC/CDD. We now turn to the second part of this paper where we look at the implementation of the FATF standards and the interventions that had to be made in order to

[800] *Ibid.*
[801] *Ibid.*
[802] See Speech by Paul Vlaanderen. 2009. *The fight against money laundering and terrorist financing in low capacity countries,* Speech by FATF President Paul Vlaanderen at the ESAAMLAG 9th Council of Ministers Meeting, Maseru, Lesotho, 21 August 2009.
[803] *Ibid.*

ensure that they do not collide with other developmental objectives of extending basic financial services to the majority of the 'unbanked' South Africans.

Implementation of South Africa's AML/CTF measures

South Africa is dominated by a few major banks known as the 'big four'. These banks control over 80% of the total banking sector assets and market in South Africa[804]. Historically, these banks have, during colonial and apartheid times, been largely serving a minority of the population[805] in a country where class and social standing was largely determined by race. At the time in which South Africa adopted the FATF standards, social movements were putting pressure on the government and the banking sector to transform and to serve the wider population. It is our considered view that implementing the FATF imposed regulations of KYC/CDD exacerbated historical problems of socio-economic exclusion with real implications for social cohesions, economic development and probably did, in some ways, compromise the achievement of the alleged goals of the FATF regime of detecting and combating crime as KYC/CDD measures had the potential, as has been pointed out, of deflecting money laundering to the unregulated sectors of the economy.

In 2002, when the former Minister of Finance, Trevor Manuel, convened the inaugural meeting of the Anti-Money Laundering Advisory Council (see Chapter 4), he urged its members to deliberate on the draft regulations and make comments[806]. This would allow him to present them to parliament for their ratification and publication in the government gazette. The AMLCRs of 2002 were finally ratified and published in December 2002[807]. Section 77 of FICA delegated the

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[804] See Appendix 6.1 for *a brief history of South Africa's banking sector* for more analysis on this.
[805] See Appendix 6.1. for a comprehensive account and analysis of South Africa's banking sector and its development over time from colonial to apartheid times and well into South Africa's transition from apartheid to democracy.
[806] *Speech by Trevor Manuel at the Inaugural Meeting of the Anti-Money Laundering Advisory Board*, 18 October 2002, National Treasury: Pretoria.
[807] See the *Money Laundering Control Regulation of 2002*. Government Gazette No. R. 1595; 20 December 2002, South African Government Printers, Pretoria.

making of AMLCRs to the executive authority of the Minister of Finance. This means that the regulations were not written and enacted by parliament, but were merely approved. It left the drafting of the AMLRCs to the Ministry of Finance. This process is applicable to many other forms of regulation-- which are regarded as secondary legislation and whose formulation is left to the executive authority in charge.

The AMLCRs started operating immediately after their promulgation in December 2002[808]. These were requirements of regulated businesses to: report suspicious transaction to the FIC; set up internal anti-money laundering policies; train staff; keep KYC and transaction records of customers; and appoint money laundering compliance officers. However other provisions started operating on June 30 2003. These related to the identification and verification of clients or what is popularly referred to as KYC /CDD[809]. Let us briefly look at those aspects of the regime which were implemented before examining the challenges encountered. South Africa's AML/CTF regime is not substantially different from those of many other implementing countries in the world. This is simply because the AML regimes of all countries emerged from a similar source -- the FATF standards -- which were transferred mainly from the US, as we demonstrated in Chapter 5. Although there might be technical variances among national regimes, all the principles of the FATF's 40 (+9) Recommendations can generally be found in most implementing countries. .

There are two types of regulated businesses in South Africa. The first group are those that are regulated only to report customer transactions and are referred to as 'reporting institutions'[810] and those that are regulated to adhere to more requirements (see below) and are referred to as 'accountable institutions'[811]. Banks, which are the focus of this Chapter, are 'accountable institutions'. Here we will interchangeably use this term with that of regulated businesses. Accountable regulated businesses are required to: (a) establish and verify the identity of their

[808] See *Government Gazette No.26487*, 21 June 2004 South African Government Printers, Pretoria.
[809] *Ibid.*
[810] The list of reporting institutions includes casinos, car dealers, dealers in high value goods etc.
[811] The list of accountable institutions includes banks, auditors, lawyers and so on.

customers before establishing any business relationship with them; (b) keep records of transactions for specified periods of time; (c) prepare and submit what are referred to as Suspicious/Unusual Activity Reports (and Cash Transaction Reports) to the Financial Intelligence Centre; (d) develop internal rules on the combating of money laundering and terrorist financing; and (e) appoint compliance officers (Anti-Money Laundering Reporting Officers) and train staff for discharging duties aimed at complying with the regime.

All these requirements, the FATF tells us, were meant to complement each other in achieving the purposes of detecting and combating crime (including terrorism) and protecting the integrity of the financial system from being abused by criminals for illicit means and ends. The FATF argued that establishing and verifying the identity of customers would help enable regulated businesses to profile customers. Profiling customers enables these businesses to identify suspicious or unusual patterns in customer transactions which might be linked to the laundering of crime proceeds or terrorist financing. Armed with these suspicions and comprehensive data of customer transactions, regulated businesses would, it is argued, be better placed to report this financial intelligence to the designated financial intelligence units. On receipt of this intelligence, the FIUs would assess it and determine which reports must receive further scrutiny of the law enforcement authorities and accordingly pass them on. The investigating law enforcement agencies would use these reports to detect crime through investigations, arrests, prosecutions and seizure and forfeiture of proceeds of crime or funds intended to finance terrorism.

Transaction Reporting Regimes

Most countries have tended to implement one or both of two main models of transaction reporting regimes. The first one requires the reporting of suspicious or unusual transactions (Suspicious Transaction Reports (STR) or Unusual Transaction Reports (UTR)), (hereinafter referred to as STRs). The second one requires the reporting of any amount beyond a certain limit or 'threshold' and is normally referred to as Threshold Transaction Reports (TTRs) or Cash Threshold/Transaction Report, (hereinafter CTRs) among others. The UK and South Africa tended to follow the STRs model. South Africa did legislate for CTRs regime but only started implementing it nine years later after the FICA was passed. When the FIC started implementing the CTRs regime, it circulated a compliance note setting deadlines for regulated businesses to comply by December 2010[812]. Countries such as the US and Australia have almost equally employed both the STR and CTR models.

The reporting of suspicious or unusual activity by banks and other regulated businesses to FIUs is one of the ultimate outcomes of the AML/CTF regime. STRs are meant to trigger new investigations against money laundering and terrorist financing and therefore assist law enforcement agencies to detect and prevent crime. In South Africa, these are submitted to the Financial Intelligence Centre. According to the FIC's latest annual report, about 98 per cent of the STRs are reported to electronically via its website, with the rest submitted manually[813]. Its reporting system also allows regulated businesses to send many reports at the same time (batch reports)[814]. Within South African banks, the reporting system is centralised to AML compliance divisions which are headed by Group Anti-Money Laundering Compliance Officers (AMLCO) at head offices. What this means is that the front-line staff of these institutions working in branches are responsible for reporting anything they suspect or see as unusual to their AML Group Compliance Divisions. The Group AMLCO and the team would then evaluate these reports by conducting further investigations, where necessary, before sending them on to the FIC. However, the AML Compliance Divisions may decide that there is no need to send an STR to the FIC and rather file it in their database[815].

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[812] *Guidance Note 05 on section 28 of the Financial Intelligence Centre Act, Act 38 of 2001*. FIC Guidance Notes, Republic of South Africa, Centurion. Retrieved from: https://www.fic.gov.za/DownloadContent/GuidanceNotes/Guidance%20Note%205.pdf

[813] See *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion. See also FATF. 2009. *Mutual Evaluation Report: South Africa.* FATF, OECD, ESAAMLG: Paris

[814] *Ibid.*

[815] *Author Interview with a Compliance Office, October 2009*.

Front-line staff would also generally not be barred from reporting their suspicions straight to the FIC[816]. This is simply because, in terms of the law, staff members of banks and other regulated businesses could be prosecuted and (imprisoned or fined) for failure to report[817]. Their institutions could also face liabilities for failure to report[818]. As a legal defence, regulated businesses could shield themselves from liability by showing that an employee handling a transaction did not report it despite having been trained to discharge this role[819]. In this case, the staff member who failed to file an STR would be personally liable for prosecution[820]. However, staff members have legal defences as well[821]. They could in their defence show/argue that they did not develop a suspicion. They may alternatively provide evidence that they made a report to their AMLCO or the FIC[822]. Lastly they could also argue that they did not receive any of the mandatory training that employers are required by law to provide to their staff[823].

In the case where an employee defends him/herself by arguing that they did not see anything suspicious or unusual in the transaction that needed reporting, a case may be complicated. This is because 'suspicious' or 'unusual' transactions are not defined in FICA and the AMLRCs. A suspicion is much more a matter of subjective judgment and there has been no jurisprudence in South Africa that has clarified this issue. However, courts could apply a reasonable person test to determine whether a person with the mandatory AML/CTF training and experience that the employee possessed should have reported the transaction as suspicious/unusual or not. One Group AMLCO told me that they encourage their staff to report suspicions to them when in doubt. He says

[816] *Ibid.*
[817] See Sections 52 (1), (2) of FICA for offences of failure to report suspicious and unusual transactions.
[818] See Part 3 of FICA for all offences.
[819] See Sections 69 (a), (b) & (c) (i), (ii) & (iii) of FICA on different legal defences available.
[820] See Sections 52 (1), (2) of FICA for offences of failure to report suspicious and unusual transactions.
[821] See Sections 69 (a), (b) & (c) (i), (ii) & (iii) of FICA.
[822] *Ibid.*
[823] See *Ibid.*

> "What we proposed is that where you are in doubt, report it and let us in the group office investigate and come to that determination because we have got a slightly more elevated level of dealing with these sorts of activities. So we promote "when in doubt, report""[824].

Threshold reporting, which was only implemented in December 2010, is viewed to be more of an objective criterion as it requires reporting of all amounts above a certain limit which, in South Africa, has been set at ZAR 25,000[825]. Countries are allowed to set their own threshold amounts and these vary by jurisdiction. In the US and Australia, for instance, the threshold is US $10,000 and A$ 10,000, respectively. In the next chapter, we examine the reporting system and how it has helped or not to detect money launderers and terrorist financiers in South Africa. Looking ahead, there does not appear to be evidence that the reporting regime has helped to detect money launderers and terrorist financiers in South Africa (See *Chapter 7*).

Anti-Money Laundering Compliance Officers

Banks generally appoint a Group Anti-Money Laundering Compliance Officer who has the overall responsibility for the AML/CTF compliance functions of the bank. This is a senior management level position which reports to the Group Compliance Officer/Executive of the bank. Group Compliance in a bank is responsible for the bank's overall compliance with all legal and regulatory requirements of the bank or what is referred to as the 'regulatory universe'[826]. For instance, other divisions falling within Group Compliance besides money laundering control would be risk management and security, fraud and monitoring, and legal compliance, among

[824] *Author Interview with a Compliance Officer, October 2009*.
[825] *Guidance Note 05 on section 28 of the Financial Intelligence Centre Act, Act 38 of 2001*. FIC Guidance Notes, Republic of South Africa, Centurion. https://www.fic.gov.za/DownloadContent/GuidanceNotes/Guidance%20Note%205.pdf accessed on 30 March 2011?
[826] *Author Interview with John Symington, October 2009.*

others. Group Compliance Divisions generally oversee compliance with the Banks Act of 1990 and a range of other laws, including AML/CTF laws and regulations that banks must comply with.

Under the Group Anti Money Laundering Compliance Officer (AMLCO), there may also be AMLCO's for each and every business unit, (i.e. branches, car finance, home loans, credit card division etc.) responsible for overseeing compliance within units and reporting to the Group-AMLCO[827]. Group AMLCO would also be responsible for internal AML/CTF policies and their development within a bank. It is mandatory for regulated businesses to appoint compliance officers or else they are committing an offence under section 62 (a) & (b) of FICA.

Mandatory Training

Staff training is a mandatory requirement for all regulated businesses under section 43 of FICA. All operational staff of banks under-go AML/CTF training and write an exam which, at some banks, they are expected to pass with more than 80 per cent before the end of their probation period[828]. Old employees also have to undergo such training and to write exams[829]. This training appears to have been internalised by banks and has become part of their staff induction programmes. In other institutions, operational staff under-go further AML/CTF training and exams before they are promoted to a senior post[830]. Banks also have to issue training certificates to staff members to prove that they have been trained and have therefore met their regulatory obligations to staff training.

They are individually responsible for developing their training programmes, but the government has assisted them by developing a standard training module for AML/CTF training through the Banking Sector Education Training Authority (Bankseta) programme, a skills

[827] *Author Interview with Compliance Officer, October 2009*.
[828] *Ibid*.
[829] *Ibid.*
[830] *Ibid.*

development project run by the government through the Department of Labour[831]. There is however a view on the part of many staff that the training developed through Bankseta was 'over-the-top' and included things which they did not necessarily need to know for their AML/CTF duties[832]. However, there is also a general sense that the banks, particularly, are the most compliant of all the regulated businesses when it comes to training.

Internal Policies

Banks and other regulated business are required to develop internal AML/CTF policies[833] which they must also submit to the Banking Supervision Division of the South African Reserve Bank and the Financial Intelligence Centre[834]. These policies guide the banks' operational measures with respect to all functions they need to perform in combating and detecting money laundering and terrorist financing. These are developed mainly by the Group AMLCO and have to be approved by the board of the bank. The banks are supposed to report on their AML/CTF operations to the FIC and the Banking Supervision Division at the end of each year or half yearly by submitting reports of what their divisions have done with regards to training, record-keeping, reporting of suspicious transactions and other related AML/CTF compliance matters[835]. It appears that there is always a lot to do within these divisions as the FATF often recommend new practices after its typology studies and often recommend changes in laws and regulations following a country's mutual evaluation exercise. One of the major issues that banks were wrestling with at the time of this research was issues of local 'politically exposed persons'[836].

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[831] *Ibid*.
[832] *Author Interview with John Symington,* October 2009.
[833] See Section 42 (1) to (4) (b) of FICA.
[834] *Ibid.*
[835] Interview with Lerato Mokhesi, Banking Supervision Division of the South African Reserve Bank, October 2009.
[836] Politically Exposed Persons (or PEPS) are defined by the FATF as "individuals who are or have been entrusted with prominent public functions" such as Heads of State or government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials and so on. See FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris: FATF Secretariat, OECD..\ http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF. Some banks in South Africa

Mandatory Record Keeping

Another key compliance issue is the keeping of client information and transactions[837]. The regulations set a standard for the keeping of all KYC information and transactions. When a client closes his account in a bank, a bank is expected to keep that information for the next five years. Many banks keep some of the information with them. Some record-keeping is outsourced to professional data storage companies[838]. This information can be kept in an electronic format and should be produced when needed by authorities. When banks or regulated businesses keep information with third parties, they are still responsible for its safety and for its production when required by the FIC and LEAs[839]. The aim of this provision is to assist law enforcement with reconstructing the trail of transactions for investigative, prosecutorial and other related purposes of tracing criminally tainted assets.

It seems that banks have gone a long way in trying to comply with these regulatory functions, having setup their AML/CTF compliance divisions, appointed the responsible compliance officers and put in place policies and controls. The main issues with banks are whether the reports they make to the FIC are contributing or not in detecting crime. There was a feeling that the FIC and LEAs are following up on the reports they make, but as to whether such reports actually contribute to any positive crime detection is doubtful (see *Chapter 7*). One participant retorted that

> "South Africa...has really gone an extra mile on being compliant with the anti-money laundering regulations...I think the time is right now for us to look at the

reported that they were compiling their local lists of PEPS as the list accessible through international databases (such as World-Check) did not have South African politically exposed persons. The FATF recommended that as way to try and combat corruption-related money laundering, regulated businesses need to conduct enhanced customer due diligence on PEPS as they fall in the high risk categories for money laundering. (*Ibid.*)

[837] See Sections 22-26 of FICA.

[838] This is permitted by section 24 of FICA.

[839] Sections 22-26 of FICA.

> crime of money laundering and to address the crime rather than just be compliant...The reality is that there is a lot of work that needs to be done to actually encourage a paradigm shift, to get the money laundering charges used."[840]

We now turn to examine the most challenging areas of compliance with the FATF standards. These were requirements for banks to 'know' their customers.

KYC/CDD requirements

From 30 June 2003, all regulated businesses including banks were prohibited from establishing business relationships with new customers unless they had established and verified their identity[841]. What this meant, in the context of retail banks, was that they could not open bank accounts for customers who had not provided the required documentation, as stipulated in the AMLRCs and Guidance Notes 3 on KYC. Regulations 2 to 18 of the AMLRCs covered the steps which regulated businesses needed to follow in establishing and verifying the identities of natural and legal persons. The focus here is on natural persons -- that is the citizens and residents of South Africa. In respect of natural persons, the regulations required prospective customers to produce identity documents, bearing that person's photograph, full names and identity number and a document with a physical/residential address which would verify where they lived[842].

In respect of South African citizens, this would be a South African green bar-coded identity document and a valid passport in respect of foreign nationals. KYC requirements are believed to assist in profiling customers, enabling regulated businesses to detect flows of criminal money through the financial system through their deviation from the 'normal' pattern for that profile. It is reasoned that if the banks do not have up-to-date information about their customers, law

[840] *Author Interview with Susan Coetzee of SABRIC,* October 2009.
[841] See Regulations 2.1 and 4.1 of the MLRCs.
[842] For Regulations 3(1) and 4(1), see Appendix 6.2.

enforcement authorities would find it more difficult to trace them should criminal investigations be initiated and pursued at a later date. The Basel Committee on Banking Supervision also compiled the "Customer Due Diligence" report in 2001, focussing on the importance of complying with the FATF's KYC/CDD regulations by banks[843]. The Basel Committee urged banks not to view KYC/CDD only as a crime-combating tool, but also as part of the risk management framework of banks[844].

It warned that failure by banks to comply with the KYC/CDD requirements exposed them to different kinds of risks including: legal liability, operational, reputational and concentration risks[845]. All these risks, according to the Basel Committee report, could lead to systemic risks that had the potential of adversely affecting the financial system[846]. The IMF and the World Bank have also generally endorsed the FATF AML regime urging countries to implement the regulations as they would assist in building prudentially sound financial institutions in a liberalised world with an interconnected financial system.

From 2003 onwards, banks in South Africa were required to start implementing these KYC regulations on their new customers. Failure to comply with KYC/CDD was made a criminal offence, exposing employees responsible for such failures to imprisonment of up to 6 months or a fine not exceeding ZAR 100,000.00[847]. To avoid breaking the law, banks would therefore refrain from conducting business with customers who could not provide the required identity and proof of residence documents. This would mean that prospective customers without these KYC/CDD documents would legally be denied bank accounts until they had produced them.[848] While, in

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[843] BCBS. 2001. *Customer due diligence for banks.* Working Group on Cross-Border Banking: Bank for International Settlements, Basel. Retrieved from: http://www.bis.org/publ/bcbs77.pdf
[844] *Ibid.pp.6-8.*
[845] *Ibid.*
[846] *Ibid*.
[847] See Regulation 29 of the South Africa's AMLCRs published in Regulation Gazette No. 7541, Government Gazette No. 24176, Vol. 450, Pretoria, 20 December 2002.
https://www.fic.gov.za/DownloadContent/RESOURCES/GUIDELINES/regulations.pdf
[848] *Author Interviews with various Compliance Officers of South African Banks, October 2009*.

South Africa, there appeared to be no major difficulties for customers to produce identity documents, there have been major problems in producing proof of residence documents[849].

KYC/CDD and its challenges: identity and proof of residence

As for identity documents, South African authorities opted to use a standard document, the South African green bar-coded ID issued by the Department of Home Affairs to every South African citizen or naturalised person[850]. The reason for insisting on a green bar-coded ID was that it was a standard document that every South African adult must have[851]. The Banking Council of South Africa had reservations with other forms of identity documents such as driver's licenses as they did not bear full names, but only initials and surnames that could be shared by many people[852]. While the bar-coded ID is widely accessible, it is also a highly compromised document that career fraudsters procure on the black market for as little as less than ZAR 1000.00[853]. There have also been dramatic incidents where, because of administrative problems, some South Africans have struggled to get their ID's from the Department of Home Affairs[854]. There is however some systemic flexibility in accepting a passport or a driver's license in the event of a customer having a reasonable excuse for not producing an ID[855]. However, bank officials sometimes demand the

[849] *Ibid.*
[850] In 2005 16 July, the Financial Intelligence Centre issued *Guidance Note 3* where it advised accountable institutions to primarily use a similar standardised documents, the green bar-coded South African Identity document, but also to use a valid South Africa Passport or a valid South African Drivers License, where the customer has lost his or her ID.
[851] *FIC Guidance Note 3: Guidance for Banks on customer identification and verification and related matters.* Government Gazette 27083, Pretoria, 18 July 2005.
[852] *New card-format driving license as ID for banking*. Banking Council of South Africa, Pretoria, Press Release: 10 March 2003. http://www.banking.org.za/search/searchdocs.aspx accessed January 2010.
[853] *Author Interview with a former DSO Investigator, September 2009*.
[854] In the past couple of years there have been some high profile incidents. In one incident an adult male in KwaZulu-Natal killed himself because he could not get his ID from Home Affairs offices in Pinetown, near Durban. In another, a young adult male held up employees of the Department of Home Affairs in Johannesburg, demanding his ID.
[855] See Regulation 4 (1) (a) (iii) of the Anti-Money Laundering Control Regulations, Regulation Gazette No. 7541, Vol. 450, Pretoria, 20 December 2002, Government Gazette No. 24176. See also *FIC Guidance Note 3: Guidance for Banks on customer identification and verification and related matters.* Government Gazette 27083, Pretoria, 18 July 2005. The Guidance Note advises banks to accept a passport or drivers license where appropriate, making a note of the staff member serving the customer and the customer's reasons for failing to produce a green bar-coded ID.

green bar-coded ID even when other forms of identification, such as a passport, are available. This is simply because many banks, in setting up their internal policies, have tended to overemphasise the green bar-coded ID over the other forms of identification.

For foreign nationals resident in South Africa, the requirement is a valid passport. For some documented refugees and asylum seekers, the situation has been uncertain. At the time of writing there were two separate pending legal litigations instituted by the Lawyers for Human Rights and the University of Cape Town Law Clinic against the government to allow banks to open accounts for refugees and asylum seekers[856]. Some refugees and asylum seekers with documents from Home Affairs, but without a passport or any other form of ID, are currently barred from opening bank accounts based on a Public Compliance Communication (PCC03) issued by the Financial Intelligence Centre[857]. This compliance notice stated that some official documents issued by the Department of Home Affairs "did not meet the requirements of an identity document in terms of the FIC Act, and its subordinate legislation"[858]. Despite these issues, there has been an advantage in using a form of a common identity document, the green bar-coded ID, which is widely available.

The main challenge in South Africa, and probably many other developing countries, has been the proof of address documents. Customers are required to produce a letter, such as a telephone, electricity or water bill, or any other related document bearing a customer's home/residential address and their name[859]. This is called a proof of residence/address. According to the regulations, it proves to the banks that customers actually live at the address stated. There is also a general practice that proof of address documents should not be older than three months[860].

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[856] See Newspaper Report by Peter Luhanga: *Refugee organisations to force government to recognise their own documents*, West Cape News (2010).
[857] *Ibid.*
[858] *Author with Ms Lerato Mokhesi of the South African Reserve Bank, 21 October 2009*
[859] See FIC Guidance Note 3: Guidance for Banks on customer identification and verification and related matters, Gazette 27083, 18 July 2005. p. 14 The verification of address documents, which all must contain the name and residential address of the person, are listed in Guidance Note 3; a utility bill; a bank statement from another bank; a recent lease or rental agreement; municipal rates and taxes invoice; mortgage statement from another institution; telephone or cellular (mobile phone) account; valid television license; recent long or short-term insurance policy document issued by an insurance company; recent motor vehicle license documentation.
[860] *Author Interviews with Compliance Officers of different South African Banks* October 2009.

The so-called international best practice standards of the FATF forbid the use of post office box addresses as these are not residential. The reason for this is that when law enforcement authorities are investigating a crime later, they would, obviously, not find people living in post boxes. This could jeopardise police investigations. Proof of residence appears to be a reasonable requirement and could potentially go a long way to assist in locating crime suspects.

In many developed countries, access to proof of residence documents can be taken for granted. Almost 100 per cent of UK households, for example, get their post delivered at home or work and they may also have bills for water and electricity. On the other hand, many households in South Africa receive their mail through the post office box, nearest shop, school or church as the infrastructure allows[861]. While many South African households get their post delivered at home, the majority still use the post-office boxes and many do not have official addresses at all, either residential or post boxes. In rural and informal settlements nearby shops, schools and churches are widely used. The cause of this situation is underdevelopment. The proof of address for KYC/CDD and international best standards bring into sharp focus the peculiar, but well documented, conditions of infrastructural shortages in developing countries.

As the dates for KYC approached, the Banking Council of South Africa (BCSA/BASA), an association for banks, issued a statement where it announced the deadlines and compliance duties of banks[862]. It noted that

> "[B]anks have both a legal and moral obligation to assist with the prevention of money laundering. Most first-world countries have well defined anti-money laundering legislation and it is important that South Africa, as part of the international community, complies with international best practice. Money that originates from illegal sources needs to be identified and the perpetrators of money

[861] Coetsee, S. 2008. *Address data exchange in South Africa, ISO Workshop on address standards: Considering the issues related to an international address standard*. Conference Paper, 28 May 2008, Copenhagen, Denmark.

[862] Banking Association of South Africa, Financial Intelligence Centre Act (FICA) Media Release 2003, Pretoria. http://www.banking.org.za/getdoc/getdoc.aspx?docid=646

> laundering…prosecuted…all banks are upgrading their internal systems and changing their account opening procedures. Branch staff will receive extensive training as part of the Know Your Client (KYC) programme."[863]

BASA further warned that the banks' obligations in respect of KYC/CDD were not only related to identifying and verifying new customers, but also the re-identification of all their existing customers by 01 July 2004. After 30 June 2003 banks started to deny service to new customers who did not possess the required KYC identity and proof of residence documents[864]. It is difficult to estimate the extent of this exclusion as banks say they did not keep any statistics of customers who were refused services for this reason. Our field research, however, sheds some light on the problem.

> "Having spent time in a branch, just account opening, I would say one in three did not have the correct documentation (proof of residence). They get sent back to come again, it's as much as that"[865].

This kind of response was prevalent in the banking industry. However there was a sense that customers got 'sent back to come again' with the correct documentation. Prospective customers would have a limited choice, especially people who had never had a bank account. This is simply because if they tried to go to another bank without the correct documentation, they would likely be sent back too as all banks were required to apply similar rules. Asked whether it was possible that many of the prospective customers that are 'sent back to come again' might get discouraged and not turn up again, another bank official said,

> "Not really, because if they did not do it with us, they would need to go and do it with other banks."[866]

[863] *Ibid.*
[864] *Author Interview with a Compliance Officer, October 2009*
[865] *Ibid.*
[866] *Ibid.*

It is however possible that many of those sent back might not 'come again'. The introduction of KYC/CDD did make it difficult to open a bank account for new customers. As one of the interviewees said;

> "If you try hard enough you will always be able to get an account. But it means that you find it a lot more difficult than a person who lives in an upmarket suburb and they have got a utility bill"[867].

Yet it is also possible that some customers had no way of proving their residence at all and thus saw no purpose in 'coming back'.

While banks were not opening new accounts for customers without documentation, they also were working hard to meet the deadlines of re-identifying their old customers by 01 July 2004. In early 2004, the FIC issued FIC Guidance Notes 1 and 2 entitled *General Guidance Note Concerning Identification of Clients*[868] and *Note on identification of Existing Clients*". Guidance Note 1 gave guidelines on how regulated businesses should go about identifying their clients by following a 'risk based' approach. Guidance Note 2 reminded regulated businesses that

> "Section 21 (2) of the [FICA] will prevent accountable institutions from conducting a transaction in the course of an existing business relation with a client after 30 June 2004 if it has not established and verified the identity of the client"[869].

This only affected old customers who had been enrolled before 30 June 2003, as anyone after the latter date would not have been allowed to open an account without the required KYC documents. Guidance Note 2 further warned that

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[867] *Author Interview with John Symington, October 2009*

[868] *FIC Guidance Note 1: General Guidance Note Concerning Identification of Clients*. Retrieved from: https://www.fic.gov.za/DownloadContent/RESOURCES/GUIDELINES/16.Guidance%20concerning%20identification%20of%20clients.pdf

[869] *FIC Guidance Note 2 "Note on identification of existing clients" in Banks Act Circular 4/2004, General Guidance Notes with regard to Anti-Money Laundering*, Office of the Registrar of Banks, South African Reserve Bank 19 April 2004, Pretoria.

> "Full compliance with this "Know Your Customer (KYC)" requirement presents a particular problem in the banking industry. It may disrupt the business relations and transactions between a bank and its clients, and between clients of different banks...The Centre [FIC] naturally expects accountable institutions to comply with these obligations."

It appears from this communication, Guidance Note 2, that the FIC was already anticipating a situation where banks would not be able to meet the deadlines for re-identifying old customers. It was also anticipating a situation where such non-compliance would cause major problems of disrupting the financial system as the accounts of customers were frozen, pending KYC/CDD compliance. In Guidance Note 2, the FIC advised that it (the FIC) and the 'supervisory bodies' would not be in a position "to excuse or pardon non-compliance with the legal obligations" of regulated businesses as the prohibition existed in primary legislation, FICA. Only parliament, through making an amendment to FICA, or a petition by regulated businesses to the Minister of Finance could provide for an extension to the impending deadlines.

The FIC had issued Guidance Note 2 after numerous alerts by banks who were struggling to re-identify their old customers. Shortly thereafter, the BASA issued a media release stating that banks were trying all they could to comply with re-identification of old customers but were finding it hard to meet the deadlines[870]. The tone towards KYC/CDD compliance within the banking sector was starting to change. In this statement the BASA pronounced that FICA was "effectively imposed on South Africa"[871] and started lobbying the government to extend its deadlines. The Registrar of Banks, who is the regulator of banks in South Africa and oversees their compliance

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[870] The Banking Council of South Africa, *Bank's Compliance with the Financial Intelligence Centre act (FICA)*, Media Release, 07 April 2004, Pretoria. According to compliance officers' that we spoke to from the banks, KYC compliance was one of the most difficult and costly processes, especially the re-identification of old customers. One of the compliance officers commented that KYC "…was quite a painful process, it costs us hundreds of millions. But it wasn't just KYC. In our bank we have many many systems that we needed to integrate. It was more of the integration of the existing systems to get a single view of the customer that cost a bank a significant portion versus the actual KYC. Yes we needed to revisit all our old customers… We used letter, smses, e-mails, ATMs…every possible means except television." (*Author Interview with a Compliance Officer, October 2009*)

[871] *Ibid*.

with AML/CTF regulations, issued the *Banks Act Circular 4/2004*. In this circular, the Registrar asked banks to submit to his office (by May 15 2004) their "completed risk matrix of their client base coupled with the number of account holders" that had been verified in terms of the KYC/CDD requirements. It appeared from these submissions to the Registrar of Banks that many banks could not meet the compliance deadlines[872]. The Registrar of Banks approached the Minister of Finance alerting him to the fact that they were unable to comply with the KYC requirements pertaining to the re-identification of old customers[873].

In his address to the National Assembly, the Minister of Finance, Trevor Manuel acknowledged publicly for the first time that the banks were finding it hard to comply with KYC regulations.

He said:

> "South Africa will meet the international standard to prevent money laundering…The 'know your customer' requirement is one such measure. It is a standard endorsed by many international bodies, including the Basel Committee on Banking Supervision as well as the FATF…As the deadline of June 30 this year [2004] approaches, this matter has caused some controversy…There is concern that the documentation requirements are too onerous and the timeframe may not be achievable. On the former, I am advised that most enquiries are based on misunderstandings and I am confident that account-holders and banks will find the regulations are sufficiently accommodating. On the time-lines, I have sought further advice and I will respond in the near future"[874].

What is clear from this speech is that the Minister believed there were two reasons for the failure of the banks to comply with the deadlines. The reasons were both that the documentation

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[872] *Author Interview with Lerato Mokhesi of the SARB October 2009*.
[873] *Ibid.*
[874] Trevor Manuel, *Appropriation Bill Speech*, National Assembly, Cape Town, 11 June 2004.

requirements were ‘too onerous’ – though he was ‘advised’ they were not -- and that the timelines were too close to be achievable. He mildly protested that the documentation requirements were not as ‘onerous’ as thought by the banks and customers – but that they might prove eventually to be ‘sufficiently accommodating’. The BASA issued a statement responding to the Minister’s speech. Bob Tucker, the CEO of the BASA said;

> “[T]he regulations are absolutely prescriptive…Moreover, far from struggling to measure up to international standards, the requirement that every single South African bank customer be re-identified and verified far exceeds all international standards and practices, taking as an example the United States of America and the United Kingdom”[875]

These exchanges seemed to show the brewing frustrations of the banking industry to KYC/CDD requirements[876]. It was, however, incorrect of Bob Tucker to claim that South Africa’s KYC/CDD compliance requirements with regards to re-identifying old customers exceeded all international standards and practice. When the UK’s Money Laundering Regulations of 2001 were implemented there, old existing customers were re-identified. It was the international standards that were not ‘sufficiently accommodating’, especially for developing countries[877]. The fact that South Africa’s AML standards were endorsed by the Basel Committee on Banking Supervision and the FATF did not necessarily translate into them being accommodative. On the contrary, it may have been the exclusion of developing country voices and input in their making that made them less than appropriate, less accommodative and also wanting in terms of democracy and legitimacy. They were not ‘sufficiently accommodating’ because South Africa had informal

[875] The Banking Council of South Africa, *FICA Response to Minister*, Media Release 14 June 2004, Johannesburg.
[876] Around this time, banks had started to freeze accounts of customers. One compliance officer of a bank told us that “Yes, yes we froze many hundreds of thousands of customers’ bank accounts” (*Author Interview with a Compliance Officer, October 2009*)
[877] Some have argued that the international standards of the FATF were flexible and therefore developing countries misread them. It is our contention that the mere fact that these standards were imposed in many countries eroded their flexibility as countries copied what had been done elsewhere. It was only after the implementation challenges that they could step back and review the rules that had been imposed and rectify their unintended effects.

settlements, townships and rural areas, the majority of which did not have the required proof of address. This was the main structural problem that other developing countries would face unless they redesigned the FATF-inspired rules to suit their socio-economic conditions.

Very shortly after this speech in Parliament, Manuel met with the bank representatives and took a decision to extend the deadline for KYC/CDD compliance on existing customers to varying dates up to September 30 2006.[878] He issued a statement in which he acknowledged that;

> "Some of the accountable institutions, mainly banks but also providers of investment services have had difficulties in meeting their obligations to know their existing customers. As a result they made submissions to me requesting exemption…given the difficulties that many of them have had, and not wanting to create an unnecessary burden for their clients, the ordinary citizens of our country…I have decided to grant banks an extension of time within which they are required to do this…This process will be completed by 30 September 2006"[879].

This followed a lengthy process from a protracted process at the Office of the Registrar of Banks at the South African Reserve Bank[880]. What this announcement achieved was to give an

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[878] Trevor Manuel, *Statement on the Identification of existing clients in terms of the Financial Intelligence Centre Act, No. 38 of 2001*, Ministry of Finance, Pretoria. 17 June 2004.

[879] *Ibid.*

[880] *Interview with Lerato Mokhesi of the South African Reserve Bank, 19 October 2009*. Mokhesi explained as follows; "When the relevant section in FICA came into force, banks expressed their inability to comply within the allocated time period for KYC compliance. They had from June 2003 and June 2004 to be fully compliant with FICA (particularly the verification of old customers). So what happened is- they wrote to the Registrar of Banks to inform him of their inability to comply. So what the Registrar did is he conveyed the message to the Minister of Finance to tell him that they will not be able to comply. So what happened is that the different banks were invited to make representations to the Registrar to indicate the different areas in which they would not be able to comply. All of them were allocated different dates on which they had to indicate what problems they encountered in trying to meet the 2004 deadlines. Remember by that date, all the customers should have been KYCd and everything in terms of FICA ought to have been done…We allocated different dates to see different banks. Each of them came with their representations. Their delegations had to consist of the Chairman of the Board, their Anti-Money Laundering Control Officer, the Chief Executive Officer of the bank and a few other officers because we wanted commitment to be made at the highest level. That is why we wanted the Chairman of the Board. So they came and made their representations. I think the biggest thing they had to contend with was with respect to KYC and verification of residential addresses."

extension for customers to find documents that many probably did not have. Those who did not have bank accounts yet and could not meet the documentation requirements were effectively not given an extension. Even if they were to be given an extension, it would not solve the problem of proof of address. We are referring to a country where a conservative estimate of 56 per cent of adults in 2004 did not have a bank account[881] and several millions lived in informal settlements or received no post at their residential addresses. These are not just the poor and unemployed, but also workers, members of the middle-class and some relatively well-off individuals living in such areas. One Group AMLCO, a middle-class and senior manager of a big South African bank whose role is to implement and ensure KYC/CDD compliance for his bank said to us;

> "In the South African environment, everybody is using their PO Boxes…I myself get nothing delivered to my house…everything goes to my post box. A significant portion of South Africans don't receive their post at their residential addresses".

The KYC issue therefore does not affect only poor South Africans and residents who may be living in poor informal settlements, but also some in upmarket suburbs. Also, the issue of human settlements in South Africa is complicated and not necessarily class-based but follows the racial lines that were drawn up by the colonial and apartheid regimes. This is to the extent, that in all these areas (informal settlements, townships and rural/traditional areas), you find a multi-class population whose common denominator is race and a shared history of colonial and apartheid oppression. It is important, since this is a case study about South Africa, to briefly paint a picture of this human settlement landscape.

[881] Bankable Frontier Association, LLP. 2009. *The Mzansi Bank Account Initiative in South Africa*. FinMark Trust. South Africa, 20 March 2009. Retrieved from: http://www.finmarktrust.org.za/documents/R_Mzansi_BFA.pdf accessed in November 2009.

Apartheid spatial distortions

Apartheid in South Africa created distorted human settlement landscapes. In 1950, the National Party apartheid government had passed a law known as the *Group Areas Act of 1950*. Through this law, it partitioned South Africa along racial lines. It designated separate settlements for whites, black Africans, Indians/Asians (South Africans of Asian descent) and Coloureds (South Africans of mixed race). To successfully implement the *Group Areas Act of 1950*, the apartheid government forcefully removed thousands to millions of South Africans and residents of all races from areas not designated for their racial groups[882]. In this racial hierarchy, black Africans were at the bottom of the chain. In urban and industrial centres they were confined to racially segregated single-sex hostels and the so-called 'black townships' -- settlements with substandard housing and limited access to a number of basic facilities and services and typically located on the urban fringe.

Colonial reserves and apartheid homelands

In the pre-democracy dispensation, settlement reflected a racial hierarchy. During colonial times, the black African population was confined to reserves and later the 'self-governing' homelands under the apartheid regime. They were only to come to the main cities and towns temporarily to provide cheap labour and (be forced to) move back to the countryside once they were unemployed[883]. Then came the Coloured and Indian/Asian settlements, which were typically

[882] Despite the *Group Areas Act of 1950*, - there were many other pieces of legislation that served to promote segregation such as *The Promotion of Bantu Self Governing Homelands Act of 1958*, *The Homelands Citizenship Act of 1972*, and *The Pass Laws Act of 1952*. Others included *The Extension of University Education of 1959*[882], which separated universities along racial lines; *The Bantu Education Act of 1953*, which-among other things- rationed the curriculum that black Africans were to be exposed to; *The Reservation of Separate Amenities Act of 1953*, which racially classified the usage of public infrastructure such as toilets, buses, beaches etc. among many others.

[883] See Meredith, M. 2007. *Diamonds, Gold and War: The Making of South Africa*. London: Simon and Schuster. pp.522-23. See also Simon, D. 1989. Crisis and change in South Africa: Implication for the apartheid city. *Transaction of the Institute of British Geographers*. New Series, Vol. 14, No. 2, Blackwell Publishing pp 198-206. The Afrikaner apartheid policies were an enhancement of the British colonial segregation policies engineered for South Africa under British colonial rule at the formation of the Union of South Africa in 1910. The pre-apartheid colonial laws include such laws as *The Mines and Works Act of 1911*, which reserved skilled jobs in the mines for whites, *The Natives Land Act of 1913* and *The Native Urban Areas Act of 1923*. *The Native Land Act of 1913* created native reserves for black

better serviced townships, compared to most designated black African settlements. At the top of the chain were white settlements -- well located and serviced areas in the cities and towns and the best arable farming areas.

Under *The Promotion of Black Self-Governing Act of 1958*, the apartheid regime established homelands for the various black African groups[884]. To complement the latter Act, it also stripped black African groups of their South African citizenship using *The Black Homeland Citizenship Act of 1970*. Under this latter Act, black Africans were generally made citizens of one of the ten black self-governing homelands, depending on their ethnicity[885]. They would also be required to carry a 'pass' at all times when in the cities and towns. A 'pass' was an identity book issued under *The Pass Laws Act of 1952*, doubling as a work permit, with a holder's full name, photograph, address, fingerprints, the name and address of his/her employer and employment history[886]. Had this unpopular document called the 'pass' not been abolished, it seems it would made an excellent KYC/CDD document. The KYC/CDD requirements of anti-money laundering have got a potential in South Africa of making those who were subjected to 'pass' laws relive the apartheid experiences of racial exclusion.

It is estimated that between 1960 and 1985, more than 100,000 arrests per annum occurred as a result of 'pass' violations, with offenders deported to their newly created 'countries' within South Africa -- the Homelands[887]. In 1961, the apartheid police killed hundreds of anti-pass protesters in the well-publicised Sharpeville township massacre near Johannesburg. Despite this suppression and partitioning of South Africa, migration trends from the homelands to the 'white

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Africans, limiting their land ownership rights to only 8 per cent (later increased to 13 per cent in 1936) of the total land area of South Africa. *The Native Urban Areas Act of 1923*, superseded by *The Native Urban Areas Consolidation Act of 1945 and 1952* designated urban areas to white South Africans, confining Africans to segregated 'locations', as long as they served white needs (cheap labour).

[884] The South African ethnic groups are Zulu, Xhosa, Ndebele, Swazi, Venda, Tswana, Sotho, Tsonga, and Shangaan.

[885] These homelands were KwaZulu, KwaNdebele, Gazankulu, Qwaqwa, KaNgwane, Lebowa, Transkei, Bophuthatswana, Venda and Ciskei. The latter four became independent states, while the other 6 refused to accept the independence status. All these Homelands were re-integrated into South Africa in 1994.

[886] Simon, D. 1989. Crisis and change in South Africa: Implication for the apartheid city. *Transactions of the Institute of British Geographers*, Blackwell Publishers, New Series, Vol. 14, No. 2, pp 198-206.

[887] *Ibid.*

apartheid' cities and towns accelerated over time with people searching for jobs, education and better life chances. Townships became overcrowded with backyard shacks erected to accommodate the extra population and provide rental accommodation for newcomers. Informal settlements, or groups of shacks, developed around the townships and other open spaces due to lack of government provisions for and non-availability of formal housing. When apartheid was near collapse in the 1980s and was abolished in the 1990s, millions of black Africans had made informal settlements and townships their homes. Those who could afford it would build decent houses in these settlements -- alongside some very poorly built structures. Thus, it is quite common to find some beautiful houses among the sprawling mud houses and shacks in many of these informal settlements today. These apartheid settlements were established without any proper social and urban development planning. They did not receive any adequate and decent services and facilities such as clinics, hospitals, schools, sanitation systems, and other services and facilities required for basic modern life from the apartheid local authorities.

They also had no adequate, if any, shopping centres, recreational facilities, banks and ATMs, formal public transport, police stations, and home deliveries of post. When apartheid was legally abolished, some black Africans, Indians and coloureds who could afford it moved to the better-served former white neighbourhoods. For black Africans there was more mobility and some also moved to the better-served Indian and Coloured neighbourhoods. Many remained (including those who could afford a choice) in these black townships and informal settlements. They had made these settlements, it appears, their homes with some households upgrading their dwellings. However, millions of black Africans, due to historical economic exclusion and lack of affordability, have had limited choices, if any. But these "citizens of our country", to use Minister Trevor Manuel's phrase, could describe exactly where they lived though they could not prove it with any piece of paper posted to their residences (proof of address) as prescribed by the FATF and South Africa's neo-apartheid laws of KYC/CDD.

Postal and residential addresses: an organised nightmare

By the end of 2004, the South African Post Office was delivering mail to 6.4 million addresses, 3 million of which were P.O. Box addresses[888]. These addresses are considered undesirable for KYC/CDD purposes because people do not live in those boxes. This being a total number of serviced addresses, it included both households consisting of multiple members and business addresses. In 1993, the Post Office launched a project called "Postboxes for all" in order to reach more households[889]. In its 2009 Annual Report, the South African Post Office reported that it was by then servicing more than 10 million addresses, more than half (about 6 million) of which were post-boxes. South Africa on the last census (2006) had more than 12 million households, with a housing backlog, according to government estimates, of about 3 million housing units[890] -- the same housing shortage as was estimated in 1994 when the post-apartheid government assumed office. Having studied various databases of South African addresses, Coetsee estimated that there were:

> "...between 7,500,000 and 11,000,000 addresses in South Africa (excluding PO Box addresses). Currently, the largest address databases in the country have between 3,500,000 and 5,000,000 addresses, implying that the backlog in addresses is somewhere between 4,000,000 and 7,000,000 addresses, i.e. around 50%. This is arguably a very crude estimate but does illustrate that the backlog is substantial."[891]

It would therefore be difficult to estimate how many South African households and individuals might struggle to produce a proof of address – though the share of the population is clearly enormous. South Africa's addressing system seems to be something of an organised

[888] *South African Post Office Annual Report 2004,* Pretoria.
[889] *Ibid.*
[890] *South Africa Post Office Annual Report 2009*, Pretoria.
[891] Coetsee, S. 2008. *Address data exchange in South Africa, ISO Workshop on address standards: Considering the issues related to an international address standard*. Conference Paper, 28 May 2008, Copenhagen, Denmark.

nightmare. According to Coetsee, the project leader of South African Address Standards, South Africa does not have a single national address database with a complete coverage of the country. Address-data is also not regulated by a central authority[892]. Existing databases are those of the Surveyor General, Registrar of Deeds, Directorate Surveys and Mapping, Municipalities, South African Post Office – almost half of whose addresses are post boxes, South African Geographical Names Council and Utilities -- which are various service delivery addresses for utilities companies such as Eskom and Telkom[893].

Even single households in a well-documented former white residential area could have different addresses or variations on a single address, listed with each of these sources[894]. This is different to many apartheid era black townships where street names were not assigned[895]. In tribal rural areas, there is communal land ownership where a traditional leader allocates land to members of the community and there are, according to Coetsee, generally no records of who lives where[896]. "Formal address allocation does not exist in the informal settlements and dwelling demarcation of the informal settlements is dynamic and after, for example, a fire, dwellings can be rearranged completely"[897]. Coetsee's illustrative examples of addresses that are used in these areas show the deepness of the problem.

> "Opposite the butcher shop, Tsamaya Street, Mamelodi"
>
> and
>
> "1st house on the right after Vodacom booth, Olievenhoutbousch".

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[892] *Ibid.*
[893] *Ibid.*
[894] See *Ibid.* Coetsee gives an illustrative example of a house in an upmarket suburb of Pretoria, Woodhill, which has 6 addresses. Its municipal street address is- *14 Glenvista Street, Woodhill, Pretoria, Gauteng*; Building Address: *Glenhills No. 6 Glenvista Street, Woodhill, Pretoria, Gauteng*; P.O. Box Address: *PO Box 153 Woodmil, Kroomdraai, 0081*; Postal Street Address: *14 Glenvista Street, Woodhil, Kroomdraai 0081*, Deeds Office ERF Description: *Pretorius Park Ext. 8, Pretoria*; and Surveyor General's Address: *Pretorius Park Ext. 8*. All these addresses are for the same house and most of them would probably meet the requirements of KYC account opening procedures.
[895] *Ibid.* 41.
[896] *Ibid.*
[897] *Ibid.*

Even emergency life-saving services such as ambulances and police are highly affected by lack of a proper addressing system. In its 2009 Annual Report, the South African Post Office reported that it was extensively expanding its roll-out of mail services to "previously disadvantaged communities" to enable them "at least to satisfy the minimum requirements of FICA". While, for the FATF and FICA, an address or proof of it is reduced to the catching of money launderers and terrorists, to many South Africans an address would mean much more. As Coetsee points out, an address is the most common form of describing a location and its purposes are many[898].

They include providing directions for delivery of services -- from visitors to postal mail, utility services such as water, sewerage and waste removal, electricity or telecommunication and emergency services (ambulances, police), voter registration and household surveys[899]. In these conditions of underdevelopment and infrastructural challenges, having an address does not only satisfy the above listed life-enhancing purposes but it could satisfy some very basic social needs. "[H]aving an address also has a social status, providing a sense of identity and of being recognised as a proper citizen."[900] When South Africa incorporated the FATF standards, authorities may appear to have lacked the full appreciation of these local dynamics. They might have had a slight idea of the impact of these anticipated challenges as De Koker points out in relation to the promulgation of the original 'Exemption 17' published with FICA in 2001[901].

Meanwhile, on the global front South Africa appeared to have impressed the FATF. In 2003, South Africa had undergone the FATF's Mutual Evaluation process and was found to have "developed a comprehensive legal structure to combat money laundering" although it still needed to "expeditiously develop a comprehensive framework to combat the financing of terrorism."[902]

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898 *Ibid.*
899 *Ibid.*
900 *Ibid.*
901 De Koker, L. 2008. *Money laundering and terror financing risk management of low risk financial products and services in South Africa: a report prepared for FinMark Trust*. The Centre for Financial Regulation and Inclusion (CENFRI), May 2008.
902 FATF. 2009. *Mutual Evaluation Report: South Africa.* FATF, OECD, ESAAMLG: Paris.

Unlike many other countries that had been put on the NCCT blacklist, South Africa had been invited to become a full member of the FATF. It joined a few other developing countries that had recently been given this exclusive status. South Africa had also assisted in the formation of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), an FATF-style regional body forming part of the global FATF network. Many non-FATF and FATF member countries have become part of the FATF family through these FATF-style regional bodies (FSRBs) which cover all the regions of the globe.

Not becoming a member of these FSRBs might not be taken too kindly in the FATF circles. It may signify a country's lack of commitment to dealing with money laundering and terrorism and could jeopardise a country's standing with the IMF and the World Bank. These latter institutions, through their Financial Sector Assessment Programme (FSAP), rate a country's compliance with 12 global regulatory standards including AML/CTF, securities, insurance and banking supervision[903]. ESAAMLG consists of South Africa and its neighbouring and East African countries[904]. In 2005/6, South Africa was also given the rotational leadership role of the President of the FATF. However on the domestic front, implementation had shown some cracks. It was easy to implement the global FATF standards and exclude millions of citizens from accessing the most basic of financial services. It would prove, however, to be far less easy to explain to these millions why they could or should not access these banking services, especially now that South Africa was a 'free' country.

Many developing countries, especially in sub-Saharan Africa, share a common history of colonialism. However, South Africa's case is compounded by its apartheid legacy of racial discrimination and spatial distortions. This South African peculiarity of legislated post-colonial (pre-democracy, apartheid) racial discrimination continues to affect social development and the

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[903] For the global standards and codes, see Appendix 6.3.
[904] ESAAMLAG Members who have signed a Memorandum of Understanding are Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Seychelles, Tanzania, Uganda, Zambia, and Zimbabwe. Retrieved from:

country's wealth distribution, making South Africa, according to economic data, the most unequal society in the world- with a gini-coefficient of 0.78 per cent[905]. While the AML/CTF regime was being implemented, there was a parallel campaign unfolding aimed at extending financial services to about 16 million 'un-banked' adult South Africans who made up 56 per cent of the adult population[906]. The KYC/CDD requirements, while they might have been well-intentioned to combat crime, were about to contribute to and reinforce an already precarious social, political and economic problem that South Africa was striving to turn around. This was the volatile issue of extending access to financial services to the previously marginalised population.

Making Banks Serve the People

As South Africa emerged from apartheid in 1994, the new democratic government set itself goals to improve the standard of living for all South Africans, especially those who had been marginalised. The country had emerged from apartheid with sharp contrasts. On the one hand, a highly sophisticated first world economy with all the characteristics of a developed country in financial services and the extractive industries, and, on the other, a third world economy with all the characteristics of underdevelopment. The policy emphasis was on improving the latter to catch up with the former. This balancing act has not been easy and continues to challenge the post-apartheid South African government as many analysts believe, at the current pace; it may take some time and even generations to accomplish.

The issue of access to basic financial services, such as transactional and savings accounts, arose out of a struggle to source housing loans in order to improve housing conditions in South Africa. When the democratic government came into power in 1994, there was and continues to be a huge backlog of unmet demands for housing. The Ministry of Housing, under the late Minister

[905] See discussion on Chapter 2 above.
[906] See Bankable Frontier Association, LLP. 2009. *The Mzansi Bank Account Initiative in South Africa*. FinMark Trust. South Africa, 20 March 2009. Retrieved from:http://www.finmarktrust.org.za/documents/R_Mzansi_BFA.pdf

Joe Slovo, was to attempt to alleviate the housing backlog, estimated at between 2 to 4 million units[907]. At that time, the limited supply of housing, particularly in urban areas, had caused a massive increase of informal settlements[908]. In the 'matchbox' township houses built under the apartheid rule, backyard shacks had mushroomed over the years and resulted in overcrowded conditions[909]. It was estimated then (1994) that between 7.5 and 10 million of the then 42 million South Africans lived in informal settlements[910].

Most of these, of course, were people with little or no income. It was estimated that in 1995, in terms of income per household, out of a total 8.5 million South African households, 7.15 million, or 86.1 per cent, had an average monthly household income of less than ZAR 3,500.00[911]. Under the new government a goal was set for the building of 350,000 new houses per year[912]. While the government had made a commitment to provide subsidies to those with little or no income, those with income would rely on the markets. The latter could, however, only be facilitated through access to housing loans from the banks. In South Africa the banks dominate the mortgage lending sector[913]. To facilitate bank lending, the government cajoled banks to extend mortgage loans to the low-to-medium cost housing market. Minister Joe Slovo signed a Memorandum of Understanding (MOU) with the Association of Mortgage Lenders in order to mobilise and encourage lending to this targeted market[914]. However, a couple of years after this MOU, the government started to express some frustration. The perception was that the banks were not lending, and were unwilling to lend, to this market.

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907 South African Government Information. 1994. *A New Housing Strategy and Policy for South Africa*. Pretoria. Retrieved from: http://www.info.gov.za/whitepapers/1994/housing.htm

908 *Ibid.*

909 *Ibid.*

910 *Ibid.*

911 *Ibid.* The breakdown of households with monthly incomes of less than R3500.00 is as follows; 39 per cent (3.3million) households with a monthly income of between R0.00 to R800.00; 29 per cent (2.41million) between R800.00 and R1500.00; 11.8 per cent (0.98million) between R1500.00 and R2500.00, and 5.6 per cent (0.46million) between R2500.00 and R3500.00.

912 *Ibid.*

913 *Ibid.*

914 *National Housing Finance Corporation Annual Report 2006*. Retrieved from: http://www.dhs.gov.za/Content/Annual%20Reports/NHFC2006_Annual_Report.pdf

In 2000, the Minister of Housing at that time, Dr Mthembi-Mahanyele and successor to Joe Slovo, warned the private sector banks that government was "running out of patience with the bank's reluctance" to extend loans to the targeted markets[915]. In terms of the MOU signed under Joe Slovo, the banks had promised to deliver 50 000 loans a year to poor communities. According to Mahanyele, "banks had not met this target" and their lending patterns showed that loans to lower income areas were declining[916]. The government was to follow this up with legislative enactments aimed at monitoring the lending patterns of financial institutions[917]. The *Home Loans and Mortgage Act of 2000,* styled on a namesake law in the US, was passed. This Act basically compelled private banks to disclose reasons for not granting home loans with the aim of ensuring that "discrimination based on reasons other than sound financial underwriting criteria" was eliminated[918]. In the Ministry of Housing's budget vote of 2001, Mthembi-Mahanyele told parliament that her Ministry was sponsoring the *Community Reinvestment Bill*[919]. The purpose of this Bill was to eliminate 'redlining' -- 'a discriminatory practice by banks not to lend to marginalised communities'[920].

It is said that the *Community Reinvestment Bill* (or CRB) was inspired by a similar law in the US, which had been passed there in 1970[921]. The CRB, when passed, would compel banks to cease discriminatory practices in extending loans, backed by criminal and regulatory sanctions[922]. When Mthembi-Mahanyele expressed her frustrations on the low number of housing loans, the issue was seized on by the South African Communist Party (SACP), a party in which she was also a member. In response to the Minister's frustrations, the SACP launched what it called the *Red*

915 Sankie Mthembi-Mahanyele. 2001. *Budget Speech by the Minister of Housing.* National Assembly, 19 June 2001. Retrieved from: http://www.info.gov.za/speeches/2001/010619245p1002.htm
916 *Ibid.*
917 *Ibid.*
918 *Ibid.*
919 *Ibid.*
920 *Ibid.*
921 *Ibid.*
922 *Ibid.*

October Campaign in year 2000[923]. It broadened the focus on financial institutions beyond housing to broader issues of financial access, employment policies and empowerment. Through this Campaign, which had many catchy slogans such as "Make Banks Serve the People" and "Red October Campaign against Redlining", 19 marches and pickets were held throughout the major cities of South Africa by thousands of protestors on 21 October 2000[924].

A petition was submitted to the government and the Banking Council of South Africa -- an association of South African banks. The main demands of the petition were that government must intervene through law and regulation in order to ensure access to basic financial services such as bank accounts and housing loans[925]. It called for a legal moratorium on 'redlining'[926] and 'classification' by private banks of 'black residential areas' as 'high-risk or non-creditworthy'[927]. It also called for an 'immediate end to racism and sexism and discrimination' and for the regulation of the functioning of Credit Bureaus'[928]. The SACP's campaign welcomed the introduction of the CRB. It mobilised support for its protest from the public and other organised formations such as communities, churches, political and labour organisations, and civil society groups. This resulted in the formation of an organisation that would take the campaign to a different level, called the Financial Sector Campaign Forum/Coalition (FSCF).

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[923] Blade Nzimande. 2002. *Address to the National Summit on the Financial Sector Hosted By Nedlac: Speech by Chairperson of the Financial Sector Campaign Forum*. 20 August 2002. CSIR Conference Centre, Pretoria Retrieved from: http://www.nedlac.org.za/summits/sector-summits/financial-sector-summit/nzimande.aspx

[924] See Mortorell, J. 2000. *South African Communist Party Red October Campaign.* 30 October 2000. Retrieved from: http://www.marxist.com/red-october-campaign301002/ The protests were against what the South African Communist Party called "racists and discriminatory banking practices".

[925] *Ibid.*

[926] See Black, J. et al., 2009. *The Oxford Dictionary of Economics*. Oxford University Press: Clarendon, 3rd Edition, for the definition of 'redlining'. It is defined as "Refusal by banks to make loans or by insurance companies to issue policies to individuals or firms in particular areas. This was justified by banks as the result of bad experience with loans or policies in these areas". The practice was criticised as being a form of discrimination against ethnic groups concentrated in such areas.

[927] See Mortorell, J. 2000. *South African Communist Party Red October Campaign.* 30 October 2000. Retrieved from: http://www.marxist.com/red-october-campaign301002/

[928] *Ibid.*

The FSCF was constituted by about 55 organisations and was led by the SACP with its Secretary, Dr. Blade Nzimande[929], as the Chairperson[930]. The FSCF proved an influential organisation in taking the campaign to more strategic policy-making avenues of government. It introduced the "Make Banks Serve the People" campaign into the National Economic Development and Labour Council (Nedlac). There, in 2001, a *Financial Sector Transformation Summit* was proposed by Nedlac's Labour and Community constituencies[931]. This Summit would bring together private banks, government, labour and community organisations represented at Nedlac to discuss and agree on how issues of transformation in the banking sector and access to financial services in South Africa should be addressed. The Nedlac *Financial Services Sector Transformation Summit* was held in August 2002. It resulted in an agreement between the constituencies represented at Nedlac, covering a wide range of issues. This included agreements on: 'the regulation of credit bureaus; introduction of legislation on cooperative banks; support for co-operative banks and non-profit micro-credit schemes; ending discrimination; ensuring access to basic financial services; expanding access to capital markets and investment; the role of state-owned financial institutions; regulating the developmental role of the financial sector and; savings initiatives'[932].

We focus on the agreement on 'ensuring access to basic financial services'. In this regard, the Summit agreed that:

1. To engage effectively in the economy, encourage savings and improve the quality of life, every South African resident should have access to affordable and convenient payments and saving facilities;

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[929] Dr. Blade Nzimande is now the Minister of Education of South Africa.

[930] The Financial Sector Campaign Forum (FSCF) is also referred to as the Financial Services Sector Coalition and was co-opted into the community constituency of Nedlac in 2001.

[931] *Nedlac's Financial Sector Transformation Summit*: Statement. 31 May 2001. Pretoria. http://www.nedlac.org.za/summits/sector-summits/financial-sector-summit.

[932] See Nedlac. 2002. *Agreements for Financial Sector Summit*. Financial Sector Transformation Summit, CSIR Conference Centre, Pretoria, August 2002.

2. In particular, people should be able to access social grants through accounts rather than by queuing;
3. Access to basic financial facilities should be ensured.

To broaden access to savings and payments requires:

a. Location of banking facilities, at least ATMs, should be within walking distance of all major settlements;
b. Affordable costs should be established for small savings accounts, payments and the transfer of pensions, relative to the incomes of poor households; and
c. Education should be provided in the use of ATMs and other basic financial services.

4. Both the public and private sector financial institutions must play a role in achieving these aims.
5. The parties will jointly research the economics of basic financial services and on that basis establish mechanisms and timeframes for achieving universal access'[933].

Speaking on behalf of the Financial Sector, Derek Cooper, then-Chairman of Standard Bank and Liberty Groups, mentioned that the industry was:

> "…fully aware of the need for the economic empowerment of all the people of this wonderful country. It would be futile to believe that there can be prosperity for some, without there being a reasonable level of prosperity for most…we are mindful and supportive of Government's determination to make appropriate changes to the structure and function of South Africa's economy…we, the financial

[933] *Ibid.* p 18.

> services sector, therefore commit ourselves to working in partnership with Government, labour and the community to bring about those changes"[934].

Derek Cooper's talk signalled an unprecedented admission of the shortfalls that the financial sector had been accused of. The "well-developed banking system which compares favourably with those in many developed countries and which sets South Africa apart from many other emerging market countries" that former South African Reserve Bank Governor, Mr. Tito Mboweni[935] had referred to in a speech he made to a press gala dinner in Pretoria, appeared to have been exposed as failing to provide accessible and affordable "24 hours a day, every day of the year" banking services to the majority of South Africans. It was, it appeared, only sophisticated for a minority of the population as basically had been the case under apartheid. The banks, it appears, had realised that they had little choice but to meet the demands which had become very glaring and political and were accompanied with real threats of legal intervention by government.

The last time there had been major political campaigns against banks in South Africa was during the apartheid days -- when Barclays, Standard Chartered and other banks ended up withdrawing their South African operations as the Anti-Apartheid Movement's campaigns intensified against them in the 1980s[936]. Derek Coopers' address was, however, measured. He asked the government, labour and community constituencies to 'partner' with the financial sector[937]. This conciliatory approach was markedly different in tone to the gloves-off address by the Chairperson of FSCF, Dr. Blade Nzimande, at the same Summit. Speaking on behalf of the Nedlac's community constituency, Nzimande charged that

[934] Derek Cooper. 2002. *Address on behalf of the Financial Sector.* Financial Sector Transformation Summit: Nedlac, NCIR Conference Centre, Pretoria, 20 August 2002. Retrieved from: http://www.nedlac.org.za/summits/sector-summits/financial-sector-summit/cooper.aspx
[935] See Tito Mboweni, *Address to the End of Year Press Gala Dinner*, 14 December 2004, South African Reserve Bank, Pretoria.
[936] See Appendix 6.1. for more on this campaign in our discussion on the history of the banking sector in South Africa.
[937] Derek Cooper (2002) Address on behalf of the Financial Sector, Financial Sector Transformation Summit, Nedlac, NCIR Conference Centre, Pretoria 20 August 2002. http://www.nedlac.org.za/summits/sector-summits/financial-sector-summit/cooper.aspx

> "Since 1994, we have witnessed numerous engagements between government, communities and the banks seeking to draw the banks into making a contribution to urgently needed transformation in our country. These engagements have particularly focussed on the provision of affordable finance to low cost housing…and providing affordable basic banking services to our people. Despite these efforts, we have witnessed and experienced…a contraction of banking services to the workers and the poor, higher charges imposed…to those able to access them…continued redlining of areas in which black working people live…"

Nzimande further declared that

> "We are convinced that neither market forces, nor appeals to goodwill of the financial sector, will fundamentally alter this pattern…We…welcome the publication of the Community Reinvestment Bill"

While Nzimande referred to government intervention through law and regulation, Cooper, on the other hand, was pushing for a softer approach to the financial sector; which resented the CRB. He suggested that out of the agreements reached by the Summit, a *Financial Sector Charter* be developed to facilitate implementation of the Financial Sector Transformation Summit[938]. The reason for the general lack of support for the alternative, the CRB, within the financial sector was that it would create mandatory obligations which were to be backed by regulatory and criminal sanctions[939]. In earlier correspondence with the former Minister of Housing, Mthembi-Mahanyele, the Chief Executive Officer of the Banking Council of South Africa, Bob Tucker, had written a somewhat brusque letter in opposition to the CRB. He reprimanded:

938 See Bob Tucker, *Chief Executive Officer of The Banking Council of South Africa: Letter to Minister of Housing, Ms Sankie Mthembi-Mahanyele.* 1 August 2002.
939 *Ibid.*

> "To suggest that the poor should flood the banking halls and demand mortgage loans that they cannot afford to repay hardly seems in keeping with the standards of good governance and sound business practice…"[940]

In 2003, the South African Cabinet, under former President Thabo Mbeki, shelved the CRB, citing the ongoing deliberations of the *Financial Sector Charter*. The legal and regulatory interventions that the Minister of Housing and the FSCF had called for were to take a back foot, overtaken by the voluntary approach expressed by Derek Cooper. In January 2004, a *Financial Services Charter* (FSC), a voluntary charter developed by the financial sector, where they agreed to a number of targets emanating from Nedlac's *Financial Sector Transformation Summit*, was signed. In this Charter, the financial sector set commitments, targets and timelines through which progress of the implementation of Nedlac's Summit agreements would be measured.

The FSC of 2004 'operationalised' a number of agreements arising from Nedlac's *Financial Sector Transformation Summit*. Here we look at this agreement which was directed at improving access to basic financial services. It is important to clarify what the Charter itself was. The FSC was a voluntary agreement and, therefore, not legally binding, developed by all the financial services sector institutions to meet various goals and initiatives of transformation. These included the provision of accessible and affordable banking services. Contrary to the legislative and regulatory intervention which the Minister of Housing and the social movements in the form of the FSCF had supported, the financial sector managed to seize the opportunity to deflect these by developing a self-regulating non-legally binding agreement. The FSC was to be monitored by and through the Financial Sector Council, a council established by clause 51.1 of the FSC, to basically monitor and oversee the implementation of the Charter. The Charter Council was described as an independent body composed of industry association representatives who must "fairly reflect the interests of all financial institutions"[941]. Its preamble stated that

[940] *Ibid.*
[941] The Financial Sector Council is governed by a Board of 21 members representing; 4 Government representatives- 2 from the National Treasury, 1 each from the Department of Trade and Industry and from the Presidency; 3 from the

> "We, the parties to this charter…commit ourselves to actively promoting a transformed, vibrant, and globally competitive financial sector that reflects the demographics of South Africa, and contribute to the establishment of an equitable society by effectively providing accessible financial services to black people and by directing investment into targeted sectors of the economy"[942].

The attitude displayed in the preamble's phrase of "providing accessible services to black people" seem to suggest a generous, charitable gesture, rather than a financial sector seeing a business opportunity in the low-end of the market. It seems to reflect an initiative that the financial sector would rather not be involved in were it not for governmental pressure to assist the poor 'black people'.

In respect of access to financial services, the Charter's clause 8 and sub-clauses acknowledge that 'access to first order financial services is fundamental to…the development of the economy'[943]. In conjunction with the Nedlac *Financial Sector Transformation Agreement*, the FSC committed the financial sector to "substantially increase access to first order retail financial services to a greater segment of the population within LSM 1-5"[944]. It further clarified what the Charter meant by "effective access" to first-order retail financial services. It meant:

- 'Being within a distance of 20kms to the nearest service point at which retail financial services can be undertaken, and includes ATM and other origination points…;

Association of Black Securities and Investment Professionals (ABSIP), 4 NEDLAC labour constituency (COSATU, NACTU and FEDUSA); 4 from the NEDLAC community constituency and 6 from the Trade Association Members. See Financial Sector Charter 2004.

[942] *Financial Sector Charter 2004*, clause 1.2.

[943] *Ibid.* Clause 8.1

[944] *Ibid.* Clause 8.3. LSM stands for Living Standards Measure- a widely used marketing research tool developed by the South African Advertising Research Foundation to group people/households according to their living standards using criteria as degree of urbanisation and ownership of cars and other major appliances. It divides the population into 10 LSM groups. LSM 10 represents the well-off group in society, sliding down to LSM 1 which represents the poorest. LSM 1to5 represent the poorest to middle income groups.

- Being within a distance of 20kms to the nearest accessible device at which an electronic (other than ATM) service can be undertaken;
- A sufficiently wide range of first-order retail financial products and services to meet first order market needs and which are aimed at and are appropriate for individuals who fall into the…categories of LSM 1-5;
- Non-discriminatory practices;
- Appropriately priced and affordably priced products and services for effective take-up by LSM 1-5; and
- Structuring and describing financial products and services in a simple and easy to understand manner.'

The FSC further defined what was meant by 'first-order retail products and services'[945]. These meant effective access to transactional and savings products such as basic current and savings bank accounts and cash cards[946]. These also included insurance and low-income housing credit to individuals or households who have a monthly income of at least ZAR500[947]. In respect of first order retail products and services, the FSC committed its signatories to targets and timeframes, among others, of 80 per cent of LSM 1-5 to have effective access to transactional and savings products and services by 2008. To further enhance the implementation of the FSC in respect of access to basic first order retail products and services, the big four banks in conjunction with the PostBank, an entity owned by the South African Post Office, launched what became known as the "Mzansi Bank Account Initiative".

[945] See *Ibid.*
[946] *Ibid.*
[947] *Ibid.* Clause 8 & sub-clauses.

KYC/CDD and the Mzansi Bank Account Initiative

The Mzansi initiative was launched in October 2004, with the aim of rolling out, in practical terms, the banks initiative of providing effective access to financial services pursuant to the *Financial Services Charter*. The Mzansi Bank Account Initiative, as a collaborative venture, was launched as an offer to provide an entry-level bank account based on a magnetic-stripe cash card. The account was intended for the LSM 1-5 market, providing a current transactional and savings account, with an ability to withdraw cash at any of the participating banks' ATMs and the Post Office, without any additional service/transaction charge. A report of an evaluation study into the impact of the Mzansi Bank Account Initiative conducted by Bankable Frontier Association (BFA) LLP and commissioned by FinMark Trust, a UK-funded financial research institute, was released in 2009. The study entitled *The Mzansi Account Initiative in South Africa*[948] evaluated the impact of the introduction of the Mzansi Account (hereinafter referred to as Mzansi) from 2004 to 2008.

It found that in that period, more than 6 million bank accounts had been opened[949]. Prior to the launch of Mzansi in 2004, out of the 48 million citizens of South Africa, 32 million were adults and could therefore open a bank account on their own. Out of the 32 million, only 13.2 million (46 per cent) had a bank account(s) and 15.8 million (54 per cent) were un-banked[950]. This was however an improvement on 1994, when only 36 per cent of adults had a bank account[951]. At the end of 2008, after just four years of Mzansi, 20.0 million South Africans (or 63 per cent) had a bank account, 11.9 million (37 per cent) un-banked[952] -- a notable improvement. For more on Mzansi and another similar initiative of branchless banking aimed at extending access to financial services, please refer to Appendix 6.4. Below we explain how the South Africa authorities

[948] Mzansi is a Zulu word which means South. It is colloquially used to refer to South Africa.
[949] Bankable Frontier Association, LLP. 2009. *The Mzansi Bank Account Initiative in South Africa*. FinMark Trust. South Africa, 20 March 2009. Retrieved from:
[950] *Ibid.*
[951] *Ibid.*
[952] *Ibid.*

managed to accommodate the unrolling of the Mzansi and branchless banking initiatives through expanding regulatory exemptions in the midst of the restrictive KYC/CDD regulations.

FICA Exemption 17

The *Financial Sector Charter* document made no reference to the AML/CTF regulations of KYC. However when one of its initiatives, the Mzansi Account was launched, the banks requested the former Minister of Finance, Trevor Manuel, to issue regulatory exemptions which would accommodate the issuing of bank accounts to clients who could not prove their addresses[953]. When this exemption was agreed to and passed by the Minister of Finance, it accommodated all new customers of banks, not only the Mzansi Account holders. The exemption, popularly known as exemption 17, was published just after the Mzansi Launch (October 2004) on 19 November 2004[954]. This exemption excused banks from complying with regulations "concerning the particulars to be obtained and verified in establishing and verifying person's identities" and from related record keeping requirements[955]. In the exemption there were also some innovative provisions. Those clients who have had their accounts opened using this exemption[956]:

- 'Would be allowed to withdraw or transfer or make payments of an amount not exceeding R5000.00 per day and not exceeding R25, 000.00 in a monthly cycle.
- Would not be able to effect a transfer of funds to any destination outside South Africa, except for a transfer as a result of a point-of sale payment or cash withdrawal in a country in the Rand Common Monetary Area.
- The account balance would not exceed R25,000.00 at any time

953 *Ibid.* p.22.
954 *Exemption in terms of the Financial Intelligence Centre Act, 2001.* November 19 2004. Exemption 17, National Treasury, South Africa.
955 *Ibid.*
956 *Ibid.* The exemption itself was probably done in a rush and was amending earlier exemptions. Its explanatory memorandum did not refer to this particular exemption but to an earlier one which was exempting the reporting of in-bound foreign exchange control violations.

- Would not be allowed to simultaneously hold two or more accounts which were opened through this exemption'.

The exemption also provided that should the provisions, listed above, be violated, offending accounts could be frozen until full KYC/CDD requirements were complied with. Exemption 17 therefore effectively enabled banks to open accounts for citizens and residents without having to provide proof of address, especially for those who did not have it. This might seem to have provided some relief to a number of clients who otherwise would not meet the KYC address verification requirements. The branchless banking products are also built around Exemption 17 to enable those without proof of residence documents to access banking services. However, has Exemption 17 solved the relative problems of financial exclusion? Yes and No.

On the affirmative, many banks are making use of Exemption 17 and in the process, accommodating millions of customers who would otherwise be excluded. On the downside, Exemption 17, according to compliance officers, tends to be used only for Mzansi and other similarly restricted banking services such as branchless banking. This means therefore that if a customer does not want the Mzansi Account because s/he needs an account with more functionality and less restriction, s/he will not be accommodated unless s/he had a proof of address. Take, for instance, the scenario painted by one compliance officer;

> "So for a guy that has upped himself in society and still wishes to remain in an informal settlement, he has got a problem. Because his activity is above those thresholds, his account gets frozen. But yet he can't unfreeze an account because he does not have a utility bill. There is an alternative way that the bank official can physically go and verify (the customers' address). But who wants to risk employees going into informal settlements to verify addresses, except that it's not economically viable."[957]

[957] Confidential Interview, October 2009

These are practical compliance challenges that regulated businesses face. Another major issue with Exemption 17 is that it appears to be non-binding and discretionary. It allows regulated institutions to use it or not to use it when they choose to. Some banks have chosen not to use Exemption 17[958] and could therefore be using more stringent rules than actually required as it is discretionary. One compliance officer told us that

> "We have not used exemption 17 and we are still not using it… If you opened a DVD contract, they do more stringent checks on your DVD contract than some of the banks do on exemption 17. Now why should a bank trust a person more than a DVD store, which is why I say there is no real solid reason why someone can't provide proof of address".[959]

In this institution customers, we were reliably informed, are turned down even if they could qualify under Exemption 17 because, as the Group Anti Laundering Compliance Officer told us of his institutions' experience.

> "I have seen people…walking in and saying "I have no proof of address", just to be difficult and we have said to them, "then you can't transact with our bank, goodbye" and they get so angry!"[960]

He continued,

> "We have normally found that the people that do not want to give us proof of address are hiding things…how many people have got TVs? Almost everybody even if it's a little portable TV. Then they are supposed to have TV licenses, if they don't we are rewarding people who are breaking the law by watching TV without a TV license. People should be having electricity because there is even electricity

[958] *Ibid.*
[959] *Ibid.*
[960] *Ibid.*

> in smaller low income areas…which over there you should have an electricity bill…It is that simple!"[961]

Since exemption 17 is voluntary, it could allow some banks to deliberately conflate issues of KYC/CDD perhaps with the intention of avoiding low-income areas and clients. For instance, to argue that low income areas would have electricity bills because they have got electricity is, at least, misleading. Many households in these areas have got prepaid electricity meters which effectively do not have any billing system and are topped up in the same way that toping up an anonymous mobile phone sim-card would be. It is also too optimistic and elitist to expect "almost everybody" in South Africa to have a TV set in order to have the paperwork to qualify to open a bank account. Weirder is also the experience in this institution that people without a proof of address should be hiding something. While many banks apply Exemption 17, some might have ignored it, perhaps out of misguided and unrealistic risk aversion or to merely discriminate some sectors of the population.

What does the FATF, the ultimate international body to which South Africa accounts for the implementation and compliance with the regime say about the sanitising KYC exemption 17? In 2008, the FATF conducted a Mutual Evaluation on South Africa[962]. With regards to KYC, and the exemptions, the report found that;

> "While the provisions of some of the exemptions fit within the FATF framework for reduced or simplified due diligence, other exemptions are overly broad and have reduced the overall effectiveness of the provisions of the FIC Act and the MLTFC Regulations"[963].

[961] *Ibid.*
[962] FATF. 2009. *Mutual Evaluation Report: South Africa.* FATF, OECD, ESAAMLG: Paris.
[963] *Ibid.* pp.91-92.

While the FATF had an adverse finding pertaining to some exemptions, it found that Exemption 17 was above board as it presents a low money laundering risk[964]. The South African Exemption 17 has become a model that has been hailed and promoted by policy entrepreneurs and other issue-oriented organisations as an example of how developing countries can continue to offer financial services to the poor while, at the same time, trying to comply with the 'international' standards of the FATF. In 2008, the World Bank based think-tank known as the Consultative Group to Assist the Poor (CGAP) released a report entitled *AML/CTF Regulation: Implication for Financial Service Providers that Serve Low-Income People*[965].

It noted KYC/CDD may bring additional costs of compliance to financial services providers and 'may restrict formal financial services from reaching lower income people'[966]. In this paper, the authors recommended that in order to avoid this 'unintended and undesirable consequence' of reducing access to financial services, developing countries would be advised to:

1. Gradually implement the KYC measures
2. Adopt a risk-based approach to regulation
3. Use exemptions for low-risk categories of transactions
4. Use transaction caps for low risk products

These proposals had apparently been borrowed from South Africa's design in the form of exemption 17. The authors wrote that

> "South Africa provides one example of how a country's AML/CTF regulations can be modified to take into account better needs of low-income clients…The South African authorities have now adopted a more flexible approach to client identification and verification and introduced a compliance exemption that relaxes

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[964] *Ibid.* p.93.
[965] CGAP. 2008. *AML/CTF Regulation: Implication for Financial Service Providers*. World Bank. Ix.
[966] CGAP. 2005. *AML/CTF Regulation: Implication for Financial Service Providers*, Washington, DC (Jennifer Isern, David Porteous, Raul Hernandez-Coss and Chinyere Egwuagu) CGAP Focus Note No. 29. p. 1.

> requirements for a category of clients known as "mass-banking clients:" those clients with small balances and small size transactions."[967]

As it appears from this report, South Africa's response and balancing act to the exclusionary KYC regulations has gained acknowledgement and interest from policy communities. A number of scholars and policy think-tanks have taken an interest in the manner in which developing countries implement these AML/CTF regulations. This interest appears to have arisen or intensified after the encountered implementation and compliance challenges, leading to the daring and necessary exemptions implemented by South Africa.

Conclusion

Over the past couple of years, some empirical comparative research has been conducted with some interesting findings on the implications of AML/CTF regulations in developing economies[968]. Some of this research has tried to explain why AML/CTF implementation has presented problems of financial exclusion in developing countries. In this concluding section we critically examine these explanations. We ask whether developing countries such as South Africa can and should fully implement the FATF regime (that is without the Exemptions), especially the KYC requirements, given their socio-economic conditions of underdevelopment?

We examine specifically the explanations given by the Genesis study[969], referred to earlier. This study found that developing countries can implement the regime but need to adapt it to their socio-economic circumstances. Adapting this regime to developing country circumstances,

[967] *Ibid.*
[968] *Ibid.* See also G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative.
[969] G:enesis.2008. *Implementing FATF standards in developing countries and financial inclusion: findings and guidelines.* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker), Final Report, February 2008, First Initiative.

according to this report, would mean applying reduced KYC requirements, including compliance exemptions such as South Africa's Exemption 17. The Genesis report, however, makes interesting observations that developing countries tend to enact stricter KYC requirements and when they fail to implement them, they start to search for solutions which suit their socio-economic circumstances[970]. This appears to be an expensive way of implementing regulation. These unintended and undesirable consequences, the report argues, would militate against the goals of the AML/CTF regime in a number of ways.

One of these is that restricting access to formal financial services makes the regime less effective as it can only monitor those who use regulated institutions -- leaving larger populations to use unregulated informal services[971]. This makes the fight against organised crime difficult when larger sectors of the population are not monitored[972]. This potentially makes detecting crime and terrorist financing more difficult as there is no regulatory surveillance and monitoring in the informal and unregulated sectors[973]. As a result the AML/CTF regime may, as mooted earlier, exacerbate money laundering by deflecting it to the underground unregulated markets, making it more difficult to conduct investigations by law enforcement agencies[974]. An effective AML/CTF regime should, according to the Genesis study, be attempting to bring as much of the population under financial intelligence surveillance as possible. The way this should be done is through encouraging more access to the formal regulated institutions than restricting it.

To rectify this problem of deflection, according to the Genesis report, the regime would have to keep on expanding its regulatory reach to cover those parts of the system that have not yet been regulated, both formal and informal[975]. The issue however with this regulatory expansionism

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[970] *Ibid.*
[971] *Ibid.*
[972] *Ibid*
[973] *Ibid*.
[974] *Ibid.*

is how far the regime will need to be expanded and how feasible and practical would this expansion be? As shown in *Chapter 2*, the AML/CTF regime has always been characterised by expansionist tendencies since its inception. Initially it focussed on drug offences and regulated only banks. It then expanded its reach to include more crimes beyond drugs and even terrorism after the 9/11 attacks in the US. In terms of the institutions covered by regulation, the regime extended its reach to encompass more financial institutions beyond banks, non-financial institutions and professionals. This may be caused by the weaknesses of the situational crime prevention approach which, as we showed in *Chapter 2*, instead of combating crime deflects it in a number of ways. The weaknesses of the situational crime prevention approach to combating crime seems to account for why criminals change their techniques or choose more informal and unregulated sectors in order to try and beat the system.

However, the problem of deflection is not only limited to crime. AML/CTF regulations do not deflect criminals and criminal activity only, but also large sectors of the (non-criminal) population to using informal and unregulated and sometimes expensive sectors of the economy because of KYC/CDD restrictions. This therefore renders the AML/CTF regulations, in general, 'bad regulations' as they are disproportionate, leading to further undesirable and unintended consequences of financial exclusion with implications for socio-economic development and increased transaction costs. Pushing large sectors of the population into the informal markets compounds the problems of accessibility and affordability. This may also seem contrary to the goal of the AML/CTF regime of protecting the soundness of the financial system, if it benefits only the few and discourages socio-economic development.

The Genesis study further observed that developing countries should not have implemented such strict measures in the first place since the FATF standards were flexible and allowed for every country's adaptation. We partially agree with this observation though it does not go far enough to explain why developing countries have tended to act in that manner. Finding explanations as to why developing countries had responded in a similar manner, i.e. adopting stricter measures than required by the FATF standards, may help us account for why they would adopt measures that were otherwise detrimental to them.

The findings of this study suggest that the global FATF regime was not only imposed on developing countries generally, but also rushed. This did not allow developing countries to appreciate the regime's flexibility. It is our view that making developing countries part of deliberative processes for policies they would be expected to implement is in their interest and would assist in identifying issues that may impact negatively on them beforehand and thus pre-empt repetition of similar problems in the future. If adopting the FATF framework had been voluntary and flexible, as claimed, developing countries would have had an opportunity to evaluate the potential costs and benefits of their national AML regimes. Perhaps some of them would have decided not to incorporate some of the measures proposed by the FATF. However, the narrow hidden interests behind the dissemination of the regime seem to have been directed at having the regime incorporated at all costs. It therefore did not matter whether the regime would actually provide the alleged publicly interested solutions to the problems that the FATF and its principals had publicly articulated. It was a matter of adopt now and complain or find solutions to arising problems later.

That developing countries were pushed into incorporating the FATF standards seems to support our private interest hypothesis that the regime emerged to satisfy narrow hidden interests. These interests appear to have been those of mainly developed countries (led by the US) of trying to prevent regulatory arbitrage, as discussed earlier, by having or forcing everyone to incorporate the regime even if such is not in their best interests. It is not in the best interest of developing countries to adopt measures that would hamper their socio-economic developmental ambitions by excluding large sectors of the population from accessing the most basic of financial services. This has the potential of maintaining and exacerbating the status quo of socio-economic inequalities as it excludes the poor from accessing essential services. It is also not in the interest of combating crime to implement measures that have the potential of deflecting rather than solving crime. In the next chapter, we look beyond KYC in order to examine the practical experiences of its impact in the enforcement of crime combating initiatives, looking specifically at the investigation of suspicious transaction reports and their effects in detecting and combating money laundering and terrorist financing. It becomes clearer that the administration of the FATF standards is far from achieving its camouflaged goals of detecting money laundering, let alone protecting the soundness of the financial system.

Chapter 7

Detecting money laundering and terrorist financing: suspicious transaction reports

Introduction

The ultimate goal of the global AML/CTF regime is to assist in the detection and combating of crime, hence the requirements for regulated businesses to report some client transactions to the recently established Financial Intelligence Units (FIUs) in many countries throughout the world. It is believed that the monitoring and surveillance of customer transactions by banks, lawyers, accountants and other regulated professionals and businesses would assist in detecting and combating serious crimes and, recently, the financing of terrorism. In this chapter, we examine South Africa's experiences with suspicious activity or transaction reporting. We ask if the reporting of financial transactions of customers to the Financial Intelligence Centre (FIC), South Africa's FIU, has helped in the detection of serious crime and terrorist financing, as claimed by the FATF and as envisaged in South Africa's laws and regulations. We seek to determine what the outcomes have been since the implementation of the reporting regime with the passing of FICA in 2001. Have the reports made to the FIC resulted in new investigations, arrests and prosecutions, convictions, confiscation and forfeiture of proceeds of crime; based upon the detection of money laundering and its predicate crimes including terrorist financing? If this transaction reporting has helped-- to what extent?

This chapter is very important in testing our competing hypotheses of public and private interests in the global emergence and domestic incorporation of the global FATF standards of business regulations. It is important because if the outcomes of the regime show that it helps to detect crime effectively and efficiently, it could therefore be shown that it was in South Africa's public interests to enact the regime. This could further validate the claims made by the FATF and its principals that the regime really emerged to detect and combat crime and to ensure the soundness of the financial system by preventing its abuse by criminals.

We found, disturbingly, that the regulation of businesses to file customer's financial transaction reports (FTRs) to the FIC cannot yet be considered to be helping to detect money launderers and terrorist financiers. Some may argue that this lack of success, perhaps, could be attributed to other factors, such as teething problems or South Africa's lack of capacity or resources and skills to investigate such reports, among others. However evidence shows that even in the initiating countries such as the US and the UK, this problem of the ineffectiveness of FTRs in detecting crime abounds. Besides that, South Africa's regime seems to have been well funded by the government. We show also that the US became aware of these problems in the late 1970s and the UK, in the 1990s. They nonetheless supported and pushed for the dissemination of the regime throughout the world, even through force -- as shown in the strategies of the FATF to unilaterally blacklist the so called NCCTs. We basically show evidence which suggests that it is only a very small portion of FTRs that are made to their FIUs which end up assisting in detecting crime. Rough estimates of other research findings of FTR regimes suggest that the numbers of FTRs that end up assisting in the detection of money laundering or crime are in the region of less than 11% and generally hover around less than one percent.

It is therefore important and appropriate to critically reflect on whether the global FATF regime really emerged and was disseminated throughout the world in order to serve the alleged public interest goals of combating crime and protecting the neoliberal global financial system or to serve other narrower agendas, such as those of competition and regulatory arbitrage. The filing of FTRs by regulated businesses is potentially very expensive as it means that regulated businesses must hire staff; train everyone who should assist in ensuring their compliance; monitor and report transactions. This clearly requires enormous amounts of human, financial and technological resources. It does not end there. FIUs, which were established through the recommendations of the FATF, must also be equipped to assess whether these reports should be referred to LEAs for purposes of investigations and asset forfeiture or not.

1. We find that South Africa's implementation of the regime has, ten year later, showed no signs of a beneficial FTR regime. We find that the regime cannot yet claim to be succeeding in detecting money laundering and terrorist financing. It therefore cannot claim to be achieving its publicly interested goals of detecting crime and protecting the soundness of the financial system against money launders and terrorist financiers it cannot detect. While there has been an increasing number of money laundering convictions in South Africa, such convictions cannot yet be attributed to the reporting of FTRs. As a result of this finding, we propose the review of the reporting regime in South Africa. A cost and benefit analysis of the regime is essential to enable the country to decide whether it is necessary or not to keep and try to improve it.

FTRs legal and regulatory framework for South Africa

The reporting of customer transactions in South Africa is covered by Part 3, Section 27 to 69 of FICA[976]. These provisions cover different types of FTRs that must be made by regulated businesses and their employees. They also provide for; access to law enforcement agencies of customer information held by regulated businesses; internal arrangements within regulated businesses for making reports; penalties (and defences) where regulated businesses fail to comply with their reporting duties. FTRs must be made to the FIC by all the regulated businesses listed in the Schedules of FICA[977]. Sections 28, 28A, 29, 30, and 31 provide for regulated businesses to report to the FIC different types of FTRs including 'threshold', 'cross-border', 'suspicious' and

[976] FICA was amended by the *Protection of Constitutional Democracy against Terrorists and Related Activities of 2004*, to incorporate matters relating to combating terrorism financing. It was also amended by the *Financial Intelligence Centre Amendment Act of 2008*.
[977] South Africa has two different forms of regulated businesses. There are those referred to as 'accountable institutions' and those referred to as 'reporting institutions'. See Chapter 4 for the differences between the two.

‘unusual’ customer transactions.. Sections 26, 27, 32, and 35, give powers to the FIC to proactively request or gain access to information (KYC/CDD and transaction information) which should be kept by regulated businesses or by third parties on their behalf. Section 26 provides for the use of a court warrant by the FIC, where needed, to access information kept by regulated businesses and third parties relating to KYC and transactions which regulated business are required to keep for a period of five years.

Discovery of information requests

Section 27 provides for what we refer to as the ‘discovery of information request’. It is used by the FIC to ascertain if particular subjects whose transactions have been reported to it are customers of any particular regulated business or not. Let us make an example of this. When the FIC receives a report from Bank A concerning Customer A, it may want to further profile Customer A. It may therefore send a discovery of information request (section 27) to Bank B, C, D and E in order to determine if Customer A has any other bank accounts with these banks.

It is envisaged that this would help the FIC to discover new information which may enable it to have a broader profile of Customer A and his transactional activities, patterns and behaviour. This discovery of information may also assist LEAs when investigating the financial intelligence referred to them by the FIC. LEAs, in this regard, would prepare subpoenas in a directed and targeted manner rather than making requests for information where Customer A does not have a bank account[978].

[978] See FATF. 2009. *Mutual Evaluation Report: South Africa*, Paris: FATF Secretariat, OECD..

Further information requests

Section 32 of FICA enables the FIC to request regulated businesses to supply 'further information' concerning a transaction report (s) they have made to it under section 28, 28A, 29 and 30. For instance Bank A may have reported a transaction by Customer A to the FIC and the latter requires more information regarding Customer A from Bank A. The FIC may, perhaps, need account opening documents and other KYC/CDD related data or a bank statement in order to assess and decide whether Customer A's transaction(s) should be referred to LEAs as suspicious, unusual or probably linked to criminal activity or not.

Supervisory bodies reports

The reporting of FTRs also extends to the AML/CTF regulatory supervisory bodies and the South African Revenue Service. Supervisory bodies are, as discussed in *Chapter 4,* sector-specific professional, self-regulatory or government regulators that share a regulatory supervisory role for AML/CTF compliance of regulated businesses. However, not all regulated businesses have a supervisory body[979]. Section 36 (1) of FICA requires supervisory bodies and the South African Revenue Service (SARS) to proactively report transactions they "know or suspect" to be connected to proceeds of crime (including terrorism financing) to the FIC. Using section 36 (2), the FIC may also take an initiative of requesting supervisory bodies and SARS to report particular information which it reasonably believes to be in their possession. The transactions covered in Section 36 must have been conducted by or with a regulated business they supervise for compliance. An example of this could be the South African Reserve Bank (SARB) detecting a suspicious or unusual

[979] See Chapter 4.

transaction conducted by or with a bank that it supervises[980]. It could therefore report such a transaction to the FIC under Section 36. This duty also extends to SARS.

While South African tax laws generally place a duty of secrecy/confidentiality on the tax information disclosed to or held by SARS, FICA somehow overrides this duty[981]. It also overrides any other similar secrecy or confidentiality duties, agreements, whether arising out of statutory or common law obligations, that supervisory or regulated institutions may claim when complying with the reporting provisions under FICA[982]. The only regulated profession that enjoys some measure of protection among regulated businesses is the legal profession[983]. The protections that the legal profession enjoy are in relation to their common law client privilege[984]. Section 38 of FICA protects all regulated businesses against any criminal or civil liability for reporting their client transactions and KYC/CDD information to the FIC.

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[980] *Author Interview with Lerato Mokhesi of the Banking Supervision Division of the SARB*, 23 October 2009. According to Mokhesi, the SARB, although a supervisory body that supervises the banking industry's compliance with FICA, it is also obliged to report suspicious transactions to the FIC. The SARB is an account opening institution, but its mandate is limited. The Financial Services Division of the SARB offers account facilities to different government departments, banks, embassies, among others, but not to household consumers. She explained regarding the SARB's duty to report suspicious transactions that "different government departments have got accounts with our Financial Services Department. From time to time they give us a list of signatories. If maybe somebody else [who is not listed as a signatory] tries to do something [perform a transaction], that we can report as suspicious."

[981] See Section 37 of FICA. One of the most controversial issues arising out of transaction reporting has been issues of client-confidentiality. The AML/CTF regulations cover a number of businesses and professions whose client-confidentiality principles have throughout the years been held as sacrosanct. This includes mainly the issues of client-confidentiality within the legal profession. Bankers, accountants, and others as well, observe some high level of professional confidentiality on their clients' affairs. The AML/CTF regime has, to an extent, been deemed to direct them to act against this principle of confidentiality when reporting transactions. This has not been taken very kindly by these professions, particularly the legal profession and accountants and bankers. The legal profession, in many jurisdictions, and the International Bar Association have challenged these regulations to the level of taking them to court in countries such as the UK, Canada and Australia. They have also lobbied the authorities within the regulatory space. Section 37 (1) of FIC ACT provides that 'no duty of secrecy or confidentiality or any other restriction on the disclosure of information, whether imposed by legislation or arising from the common law or agreement, affect compliance' with reporting obligations under FICA. The only exception is given to the common law right to legal professional privilege as between an attorney and the attorney's client in respect of communication made in confidence between them or a third party for purposes of legal advice or litigation which is pending, contemplated or which has commenced. The privilege does not cover situations where attorneys act as intermediaries in financial transactions such as conveyancing.

[982] See South Africa's Financial Intelligence Centre Act, Act No. 38 of 2001 as amended. Section 37.

[983] See *Ibid.* Sections 37 (2) (a) and (b).

[984] *Ibid.*

Monitoring orders

Another important power that the FIC has is that of applying for 'monitoring orders' in terms of section 35 of FICA. Monitoring orders are issued by a court on application by the FIC and order a regulated business to report every transaction of a particular customer to the FIC for a period of 3 months. These orders are renewable through further court applications. Related to monitoring orders are intervention mechanisms that the FIC has to temporarily delay transactions.

Intervention mechanisms

Using section 34, the FIC can intervene by delaying transactions of customers of regulated businesses for a period of no longer than five working days[985]. This five day delay allows the FIC to notify the NDPP to apply for a freezing order of funds in terms of Chapter 5 or 6 of POCA and other similar provisions in terms of the Protection of Constitutional Democracy Against Terrorism and Related Activities of 2004 (POCDATARA). The NDPP, as discussed in *Chapter 4*, has delegated this power to the AFU. The responsibility of the AFU is to confiscate and forfeit proceeds or instrumentalities of crime in line with POCA and POCDATARA. Within that five day Section 34 intervention period, the AFU may apply for a restraint or freezing order, using POCA, to freeze or preserve such funds for a longer period (90 days) while investigations take place[986].

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[985] In the UK this is referred to as 'consent disclosures'. They are filed with the UKFIU, giving it an opportunity to review and give consent within 7 working days. This is much more relevant on regulated businesses who are alerted of future transactions of their clients such as lawyers in divorce matters. For instance the divorce settlement to be made may be made with proceeds of crime, such as tax evasion. By carrying on with facilitating a divorce settlement, an attorney may be facilitating the acquisition of proceeds of tax evasion, a criminal offence. As a result, solicitors and barristers in the UK were advised to seek consent and advice from UKFIU on such matters. See *Bowman v Fels* [2005] EWCA Civ 226 (08 March 2005). http://www.bailii.org/ew/cases/EWCA/Civ/2005/226.html

[986] See Chapter 4 on POCA's asset forfeiture orders above.

‘Tipping-off’ offence

Section 29 (3) of FICA prohibits what has become known as ‘tipping-off’; that is informing a client that his/her transaction(s) has been reported to the FIC and details of such reports. The rationale behind the ‘tipping-off’ offence is to guard against suspects taking action that would jeopardise investigations such as depleting the funds.

Access to information held by the Centre

Lastly, Sections 40 and 41 cover issues of access to information held by the FIC and parties entitled to access such information such as the designated LEAs[987], the South African Revenue Service and other supervisory bodies and the country’s intelligence agencies. Other bodies entitled to access such information are foreign FIUs, with which the FIC shares information (on request) via the Egmont Group’s Secure Web[988].

Types of Financial Transaction Reports

There are two broad categories of FTRs that are prescribed for reporting by regulated businesses worldwide. These are ‘threshold’ and ‘suspicious’/’unusual’ transaction reports.

[987] The Assets Forfeiture Unit, Directorate of Special Operations (then), South African Police Services, National Intelligence Agency, South African Secret Service, Exchange Control Division of the South African Reserve Bank (ExCON) and the South African Revenue Service.

[988] This seems to be one of the most interesting aspects of these regulations. Foreign intelligence services do not necessarily need to have a mutual legal assistance which goes through the ministry of justice and is authorised by the courts in order to access financial intelligence held by the FIC. They only need to send a request to the FIC and the FIC sends that financial intelligence to them without a warrant or court order. FICA does not seem to provide for any formal legal guidelines or safeguards; making such information open to abuse as the whole operational environment of FIUs is shrouded in secrecy. Information held by the FIC may also be accessed by those entitled to it through legal proceedings and its production can be ordered through a court order. Later on here we look at the institutions set up in South Africa to investigate organised and serious crime and to whom, financial intelligence, is crucial in their work. At the moment we discuss the concept of financial transaction reporting, the practical challenges for complying with the reporting requirements by regulated institutions and justifications and uses of financial intelligence for law enforcement purposes. .

Threshold-based reporting is based on the setting of minimum transaction amounts above which a regulated business must report to an FIU. These thresholds differ per jurisdiction and currencies. Section 28 of FICA requires the reporting of Cash Transaction Reports (CTRs). This was not implemented in South Africa until late 2010. All regulated businesses are now obliged to report all transactions above ZAR 25,000 to the FIC[989]. It is not clear why the South African authorities chose this CTR amount as it seems significantly lower than those of other jurisdictions and is likely to cause a flood of reports which may be difficult to connect with any criminal activity by the FIC and LEAs, as has been experienced in other jurisdictions.

For instance, in 2009 alone AUSTRAC and FinCEN received more than 14 million CTRs each[990]. The US has, since the early 1990s, been seeking to address the problem of 'over-reporting', as most of the CTRs it gets, according to the US government's research, are "useless for law enforcement purposes"[991]. One of the major shortfalls that has been found with CTRs is what is known as 'smurfing' or 'structuring'. This happens when criminals conduct multiple transactions which are just below the reporting threshold to avoid being reported. To accommodate this flaw, section 29 (b) (i to iii) of FICA requires the reporting of a series of such structured transactions as 'unusual' or 'suspicious'.

Related to CTRs are cross-border – cash, negotiable instruments and electronic transfers. Section 30 and 31 of FICA respectively requires the reporting of threshold cash or electronic transfers into and out of South Africa. In practice, these transactions are supposed to be reported

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[989] See Financial Intelligence Centre. 2010. *Guidance Note 05 on section 28 of the Financial Intelligence Centre Act, Act 38 of 2001*. Guidance notes. Republic of South Africa, Centurion. https://www.fic.gov.za/DownloadContent/GuidanceNotes/Guidance%20Note%205.pdf accessed on 30 March 2011. Under FICA, section 1, 'cash' is defined as physical "coin and paper money" and "travellers' cheques" and excludes 'negotiable instruments', 'transfer of funds by means of a bank cheque, bank draft, electronic funds transfer, wire transfer or other written order that does not involve physical transfer of cash'. p. 3.

[990] See AUSTRAC *Annual Report 2008/09*. Australia. http://www.austrac.gov.au/files/ar0809.pdf pp.17 to 30. In Australia, 16,325,870 of the 19,771,903 FTRs reported in 2008/09 financial year were CTRs. See *Financial Crimes Enforcement Network Annual Report 2009*. United States. http://www.fincen.gov/news_room/rp/files. In the US FinCEN received 16, 740, 102 FTRs, 14,9 million of which were CTRs.

[991] See Government Accountability Office. 2008. *Bank Secrecy Act: Increased Use of Exemption Provisions Could Reduce Currency Transaction Reporting While Maintaining Usefulness to Law Enforcement Efforts*. Report to Congressional Requesters, United States (February 2008) p. 2.

to the Exchange Control (ExCon) Department of the South African Reserve Bank, which administers the country's reputably strict, but slowly liberalising, exchange control regime. The FIC has got an arrangement to access such reports from ExCon[992]. For the purposes of this Chapter we combine both cross-border transfers and CTRs- as they are both threshold based, and refer to them as CTRs.

Section 29 (a) requires all regulated businesses to report 'unusual' and 'suspicious' transactions when they 'know or ought reasonably to have known or suspected' that their business has or was about to receive proceeds of unlawful activities or property connected with crime or the financing of terrorism. It becomes difficult, however, for regulated businesses to know or suspect which transactions flowing through them may fit the bill. However, it is reasoned that if they profile their customers through such set requirements as Know Your Customer and the UN's terrorist/sanctions lists, they could be able to form an opinion as to which customer transactions to report as suspicious and unusual. FICA does not define what is meant by 'suspicious' or 'unusual activity', but a number of guidelines have over the years emerged with an aim of guiding regulated businesses to comply with their reporting duties[993].

The FATF standards have generally allowed some discretion for countries to choose their reporting regimes between CTRs and STRs. While many jurisdictions have opted for both, some have tended to use mainly the STRs regime. In the early years, the US tended to use mainly the CTRs regime. In 1994, however, the US also started to emphasise STRs. The US and Australia now apply both these reporting regimes[994]. In respect of CTRs, the threshold set for reporting in the US is US$10,000 and in Australia, A$ 10,000, a significantly larger threshold compared to South Africa's ZAR25,000 (equivalent US$3,000 at the time of writing). The UK has been

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[992] See FATF. 2009. *Mutual Evaluation Report: South Africa.* Paris: FATF, OECD, ESAAMLG.
[993] See discussion below
[994] Hinterseer, K. 2003. *Criminal finance: the political economy of money laundering in a comparative legal context*. Kluver Law International: The Hague, London, New York, p.185. See also Montano, E. 2002. Wealth hidden, tax evaded: strategies for revelation. *Journal of Money Laundering Control*, Vol. 5, No. 4, London: Henry Stewart Publications.

reluctant to utilize the CTRs method, favouring STRs instead. It was only with the UK's Money Laundering Regulations of 2001 and 2003 that the CTRs regime was fully incorporated to accommodate cross-border transaction reporting requirement-(of EU 15,000 threshold) in compliance with the second EU Directive against Money Laundering[995].

The main reason for favouring the STR as opposed to the CTR system has been based on the view that CTRs tend to 'swamp' the system, making the reporting regime unmanageable[996]. There might be some validity to this view as countries that use it seem to have amassed huge databases of CTRs, which research suggests are often legitimate transactions or cannot be linked to any criminal activity. For instance in 2001 alone, AUSTRAC, collected about 7, 5 million CTRs compared to about 7000 STRs[997]. At the end of 2008/09 financial year, it received just below 20 million FTRs (both STRs and CTRs); that is an equivalent of 76000 reports per day[998]. Only 32, 449 were STRs[999], the rest being CTRs[1000].

In the UK, on the other hand, between 1995 and 2000, the NCIS (NCIS incorporated UK's Financial Intelligence Unit then) had received below 20 000 STRs per year[1001]. It was only in 2001 where the numbers started to swell to just above 30 000; 63 000 in 2002 and about 100 000 in 2003, following the UK's introduction of new regulations[1002]. When the number of transactions reported to the NCIS started to rise, there was a lot of scepticism about the NCIS's capacity to

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995 Alldridge, P. 2003. *Money laundering law: forfeiture, confiscation, civil recovery, criminal laundering and taxation of the proceeds of crime*. Oxford: Hart Publishing..

996 Gold, M, & Levi, M. 1994. *Money laundering in the UK: an appraisal of suspicious-based reporting*. London :The Police Foundation.. See also Maylam, S. 2002. Prosecution for money laundering in the UK. *Journal of Financial Crime*, Vol. 10, No. 2, London: Henry Stewart Publications., Editorial pp.157-158.

997 Montano, E. 2002. Wealth hidden, tax evaded: strategies for revelation. *Journal of Money Laundering Control*, Vol. 5, No. 4, : London: Henry Stewart Publications, p. 264.

998 See *AUSTRAC Annual Report 2008/09*. Australia. http://www.austrac.gov.au/files/ar0809.pdf pp.17-30.

999 *Ibid.* In Australia STRs are referred to as Suspicious Matter Reports (SMS). .

1000 *Ibid.* Cash Transaction Reports are referred to as Threshold Transaction Reports in Australia and include reporting of transactions of any currency above AU$10 000 and International Fund Transfer Instruction Reports which amounted to 16,325,870 transaction reports (of the 19,771,903 reported) at the end of 2008/09 financial year.

1001 KPMG, 2003. *Money laundering: review of the reporting systems.* London: UK Home Office., p. 15.

1002 *Ibid.*

analyse and disseminate these reports to LEAs promptly in order to detect or prevent crime[1003]. This scepticism arose mainly from the NCIS's backlog of unprocessed STRs, which were not disseminated to LEAs for periods as long as over a year[1004]. At that time, it was NCIS policy that all STRs received should be analysed, allocated and disseminated to designated LEAs[1005].

There are also challenges with the STR system. For instance, studies show that they could be 'swamped' by regulated businesses who report defensively just to avoid being fined. In 2003, the Royal Bank of Scotland was fined £ 750,000 by the Financial Services Authority. Its Chief Executive then, Fred Godwin, was quoted as having complained that the penalties imposed by the FSA were "so draconian that you might as well report every transaction"[1006]. The system in the UK was reviewed with the formation of the Serious Organised Crime Agency (SOCA), which the UK Financial Intelligence Unit (UKFIU) is now part of[1007]. According to SOCA's 2009 Annual Report, it received only 228, 834 STRs (which in the UK are referred to as suspicious activity reports (SARs).

The CTR system is, however, regarded as more objective for its clarity on what to report as compared to the STR system[1008]. Many regulated businesses in the UK, for instance, have in the past complained that there were no threshold amounts set for reporting. This issue was particularly raised in the presentation of the Law Society of England and Wales in the case of *P v P*[1009]. The judge, Butler-Sloss P, in this case clarified that "an illegally obtained sum of £10 is no

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[1003] *The Daily Telegraph* (December 23, 2003) cited a backlog of 58 000 previous years' STRs that the NCIS had not dealt with by May 2003, and also conveying little confidence on the NCIS capacity to cope with over 100 000 to 150 000 STRs respectively expected in 2003 and 2004 reporting years. See Hlophe, Z. 2004. *Assessing the effects of anti-money laundering regulations in the UK: Suspicious Transaction Reports and their effect in detecting money laundering*. Unpublished MSc Dissertation. University of Leicester, UK.

[1004] See *Ibid.*

[1005] See below.

[1006] The Daily Telegraph: (23 December 2003) cited in Hlophe, Z. 2004. *Assessing the effects of anti-money laundering regulations in the UK: Suspicious Transaction Reports and their effect in detecting money laundering*. Unpublished MSc Dissertation. University of Leicester, UK.

[1007] See Serious Organised Crime Agency. 2009. *Suspicious Activity Reports Regime: Annual Report 2009*. United Kingdom.

[1008] Alldridge, P. 2003. *Money laundering law: forfeiture, confiscation, civil recovery, criminal laundering and taxation of the proceeds of crime*. Oxford: Hart Publishing. p. 262.

[1009] *P v P* ([2003] EWHC Fam 2260).

less susceptible to reporting…than the sum of £1 million". At paragraph 56 she stated that: "Parliament intended this to be the case. Whatever might be the resource implications, the legal profession would appear to be bound by the provisions of the Act[1010] in all cases, however big or small."

Under the STR system, the issue of what transactions should be considered suspicious can only be couched in general terms. Hanson[1011] states that, generally, a suspicious or unusual transaction, especially within the banking sector, would involve the following red-flags; large cash deposits; large cash withdrawals; frequent cash deposits; frequent cash withdrawals; pattern of visits to a safety deposit box followed by cash deposits; large money transfer -- incoming or outgoing, or in combination; a large incoming money transfer followed by an outgoing payment; frequent money transfers: incoming, outgoing, or in combination; any money transfer received from, or sent to, an offshore bank; frequent financial transactions of any kind involving amounts just under any applicable reporting limit; patterns/volumes of financial transactions not in line with the account stated purpose and; patterns/volumes of financial transactions not in line with previous account history.

The UK's Joint-Money Laundering Steering Group's (JMLSG) Guidance Notes of 1994 also cited similar issues[1012]. For institutions to determine suspicion they needed to ask themselves, among other things, the following questions;

- Is the size of the transaction consistent with the normal activities of the customer?
- Is the transaction rational in the context of the customers' business or personal activities?
- Has the pattern of transactions conducted by the customer changed?

[1010] *United Kingdom's Proceeds of Crime Act of 2002.*

[1011] Hanson, A. 2004. *Banking transactions don't raise the red flags*, Associated Press Professionals. https://www.offshore-fox/financial-privacy/offshore_banking_020502.htm.

[1012] See *Hosni Tayeb v HSBC Bank Plc and another* ([2004] EWHC 1529 (Comm)).

- Where the transactions are international in nature, does the customer have any obvious reason for conducting business with other countries involved?

A litany of items could still be added to these lists by Hanson and the JMLSG. These include; the receipt or transfer of funds to and from FATF blacklisted jurisdictions, transactions from or to politically exposed persons (PEPs) and terrorist blacklisted individuals and groups, and such controversial and prejudicial factors as the ethnicity and nationality of customers, among others. The point that needs to be emphasised, however, is that a majority of transactions that may look suspicious could well be legitimate and not linked to any criminal activity.

A landmark case on the latter point is a UK civil case[1013] between Dr Hosni Tayeb (plaintiff), a Tunisian national, and the UK's HSBC bank of which he was a customer. Tayeb's account at HSBC received an electronic deposit of UK£ 944,114.27 from Barclays Bank. Unbeknown to the bank manager at HSBC, Tayeb had sold a database to a Libyan company known as *General Posts and Telecommunications Company*, and the transfer was payment for the database. On receipt of this huge amount, the HSBC branch manager got suspicious of money laundering and arranged for the money to be re-transferred back to the sending Barclays Bank account. Tayeb sued HSBC for breach of contract. The judge, Mr. Justice Colman, found HSBC liable to pay Tayeb the whole database sale amount plus interest from the date of the transaction. Mr. Justice Colman held that the transfer of money to Tayeb's account was legal and the bank manager should have simply filed an STR with authorities. On par. 66 Justice Colman held that

> "Giving all due weight to the need to comply…and to the objective of discouraging money laundering transactions or transactions involving the proceeds of crime, as reflected, for example, in the Basel Committee Report, the argument that in order to protect the interests of the bank, the express regime of the CHAPS Rules can be ignored by the transferee bank by reference to some overriding concept of banking

[1013] *Ibid.*

practice designed to achieve disengagement of the bank from a transfer of funds as to which it justifiably entertains suspicions can carry little weight unless there is cogent evidence of a settled banking practice to this effect… Notwithstanding the bank's justifiable suspicions, the transaction giving rise to the transfer may be perfectly lawful and the customer may therefore be entitled to expect performance by the bank of its banking contract... If banks are to be entitled to depart from their contracts with customers, on the basis of suspicion of unlawfulness and of general banking practice, that practice has to be clearly proved. That such alleged practice goes well beyond what is necessary to protect the bank from unlawful activity may be a strong indication that no such practice exists."

This case reflected some operational failures and costly judgments that many regulated businesses can get caught up in while trying to comply with the reporting regime. In this case, it seems that the bank manager was either trying to avoid a reporting duty by retransmitting the money back to where it came from or simply did not know what to do and acted haphazardly, exposing his bank to liabilities, despite his experience of over 20 years in banking[1014].

The South African system has not been tested yet. There have neither been litigation nor enforcement fines against regulated businesses for failure to comply with these new reporting duties, except in one plea-bargained case of *S v Maddock*[1015]. A number of regulatory fines have been handed down in the UK and the US for failure to comply. To better equip themselves to make reports to FIUs, regulated businesses have turned to technology to help them monitor and identify transactions that need reporting. This is simply because in this technologically advanced era, many customers of banks are increasingly using virtual electronic payment systems such as internet banking, automated teller machines, point of sale terminals (POS), telephone banking, etc. They

[1014] See *Hosni Tayeb v HSBC Bank Plc and another* ([2004] EWHC 1529 (Comm)).
[1015] See *S v Maddock Incorporated and Another* (0) [2008] ZACOMMC 1 (1 February 2008) http://www.saflii.org/za/cases/ZACOMMC/2008/1.html

therefore would not walk up to a teller who has been trained to detect suspicious activity, but to virtual transaction systems.

Transaction monitoring by regulated businesses

A number of transaction monitoring systems aimed at assisting regulated businesses to cope with detecting reportable transactions have emerged over the past couple of years[1016]. These have been developed by a number of private firms to assists particularly banks, which most need them because of the numbers of customers and transactions they have to process on a daily basis. While threshold-based transaction monitoring software has existed for a long time, there has been an emergence of systems that allow financial data to be used to build profiles of individual customer behaviour - which Schudelaro refers to as "behavioural monitoring systems"[1017]. Schudelaro mentions how these monitoring software products operate:

> "…behavioural profiling systems in essence compare all characteristics of a payment, not only to all characteristics of previous payments by the same individual or entity, but also to those of other, similar payers. Transaction monitoring systems can keep records of who made what kind of payment, to what amount, when, where, and to whom. In this way, a kind of fingerprint of individual customer behaviour can be obtained. This in turns enables the detection of patterns that are unusual…because of the volume, the amounts, or the persons involved…Nowadays systems exist that can handle tens of millions of transactions daily…"[1018]

From this explanation, these technologies should make it easier, especially for banks to detect unusual activity in their customer accounts. However, there might be weaknesses in these

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[1016] Schudelaro, A. A. P. 2003. *Electronic payment systems and money laundering: risks and countermeasures in the post-internet hype era*. Nijmegen: Wolf Legal Publications.
[1017] *Ibid.* p.225.
[1018] *Ibid.* p.286.

systems. One, they red-flag or highlight those transactions based on the programmers' rules. Professional criminals who acquire enough information on how these systems work can adjust their transactions to appear normal and not easily detectable by threshold-based monitoring systems. An example of this is on the cash transaction reports where a system is set to flag transactions beyond a particular limit, i.e. $10 000, allowing criminals to 'smurf' transactions below the reporting threshold[1019].

Even those systems that are based on behavioural profiling still require human beings to take decisions on whether to report them as suspicious[1020] or not. With thousands to millions of transactions taking place in any single minute, physically over the counter, via the internet and e-payment systems, regulated businesses still have to sift through a number of transactions already flagged by these systems[1021]. The use of transaction monitoring software does not absolve regulated businesses of their reporting duties. Equally, transactions flagged still need to be manually checked as these systems may end up producing many false positives. A major problem could also be with transactions that do not get "red-flagged" by the programming filters as they may be literally ignored. Many regulated businesses are increasingly making use of automated transaction monitoring systems, especially those with higher transaction volumes such as banks.

The 3rd EU Money Laundering Directive has led the Financial Services Authority (FSA) of the UK to make transaction monitoring by regulated businesses compulsory[1022]. Many banks were already doing this, although transaction monitoring was not explicitly mentioned as a requirement in the regulations[1023]. Technically, since the regulations require reporting of suspicious transactions, such transactions can only be picked up or verified by staff to be

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[1019] *Ibid.* See also Veyder, F. 2003. Case study: where is the risk in transaction monitoring?. *Journal of Financial Regulation and Compliance,* Vol. 11, No.4.
[1020] See Schudelaro, A. A. P. 2003. *Electronic payment systems and money laundering: risks and countermeasures in the post-internet hype era*. Nijmegen: Wolf Legal Publications.
[1021] *Ibid.*
[1022] FSA. 2007. *Automated Anti-Money Laundering Transaction Monitoring Systems.* London: Financial Services Authority, United Kingdom..
[1023] South Africa's AML/CTF regulations do not place any duty on regulated businesses to use automated monitoring systems.

suspicious, hence the AML/CTF training requirements for staff to be able to identify suspicious and unusual transactions that require reporting. To put in place requirements for automated monitoring will force regulated businesses to put these systems in place. This may close some technical loopholes, especially where regulated businesses may argue that some transactions were not reported because their staff did not detect them as suspicious since they were not carried out by tellers, but through the internet or other automated systems. Unlike staff members which the regulations require their training, computers cannot be trained, but they can be programmed. There could therefore be a loophole when regulations do not explicitly provide for computers/electronic transaction systems of regulated businesses to be auto-programmed to detect suspicious or unusual transactions.

There may therefore be a need to regulate businesses to monitor transactions on their automated systems. However, there may be some problems with this, as regulations would, perhaps, have to prescribe and set uniform parameters for all monitoring systems to comply with. Occasional and timely updating of such uniform parameters may also be required in order to ensure that they keep up with new money laundering techniques and trends. This may be very costly for regulated businesses if it is prescriptive and rules-based.

Uses of FTRs for law enforcement purposes[1024]

FTRs have generally been claimed to assist law enforcement purposes in two broad ways; tactically and strategically[1025]. The former refers to their tactical short-term role in assisting to detect or investigate crime and the latter, to their strategic uses for longer-term planning and

[1024] See Appendix 7.1. for a more detailed account of this section.

[1025] See Fleming, M.H. 2005. *The UK Law Enforcement Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime*, University College London. http://www.jdi.ucl.ac.uk/. Serious Organised Crime Agency. 2006. *Review of the Suspicious Activity Reports Regime (The SARs Review)*, Sir Stephen Lander, March 2006. http://www.soca.gov.uk/about-soca/library/doc_download/80-lander-review-2006. See also Appendix 7.1.

management purposes[1026]. For tactical, short-term law enforcement or investigative purposes, they have been found to be of help in initiating new investigations. They also assist with information and evidence leads in ongoing cases[1027]. For strategic purposes, they could assist the authorities in providing strategic information which may not only help with investigations, but with the management of the whole regime, including compliance enforcement by non-compliant regulated sectors[1028]. For reasons of space, we have put a more thorough discussion on the uses of FTRs for law enforcement purposes in Appendix 7.1. The changes in practices and management of FTRs, over the years, in both the UK and the US, seem to paint a picture of regimes which are still evolving with a lot of teething problems, despite the number of years in which they have been implemented (about 40 years in the US and over 20 years in the UK). The reporting regimes in these countries have continuously been undergoing regular reviews which clearly points to the ineffectiveness and inefficiency of these countries regimes in detecting crime.

Changes in UK FTRs regime

In the UK, the NCIS was formed in 1987 and used to send all the FTRs it received from regulated businesses to designated LEAs[1029]. Before doing so it would 'analyse' the reports, thus adding some value, before sending 'intelligence packages' to LEAs for investigations. This value-adding analysis involved cross-checking FTRs against NCIS and other LEA databases, particularly the National Police Computer, a database of everyone who was ever arrested and charged by the police in the UK[1030]. When these checks were returned as a positive hit, an FTR would then be sent to a designated LEA. New FTRs which did not return any hit from database

[1026] *Ibid.*
[1027] *Ibid.*
[1028] *Ibid.*
[1029] See Fleming, M.H. 2005. *The UK Law Enforcement Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime*, University College London. http://www.jdi.ucl.ac.uk/.
[1030] See *Ibid.*

checks would be allocated and disseminated using the UK's post-code system and allocated to the LEA of that post-code[1031].

After an evaluation study commissioned by the NCIS and conducted by KPMG[1032] in 2003, UK's reporting system was revised. NCIS started analysing all FTRs individually, on a "qualitative basis and according to the intelligence requirements" of LEAs and the NCIS[1033]. Those FTRs which did not meet these undisclosed criteria were kept on the NCIS database (known as Elmer) and not disseminated to LEAs, as had initially been done prior the KPMG review[1034]. However due to the increased number of FTRs received and backlogs in their processing, especially following the passing of the Proceeds of Crime Act of 2002 and the new Money Laundering Regulations of 2003, the NCIS reported that it had significantly decreased the numbers of FTRs it was proactively sending to LEAs for investigation[1035]. It started also to send Compact Disks of unprocessed FTRs to some agencies[1036]. The NCIS further reported that the process of analysing FTRs 'one by one' "risked not revealing the most capable and most prolific of money laundering suspects and not highlighting patterns and typologies"[1037].

This process was replaced by 'the delivery of intelligence assessments, prioritised subject lists and targeted' FTRs[1038]. Such targeting was to be supplemented by a new system which allowed a nationwide read-only access to the NCIS database by LEAs, through an extranet system called *money web*[1039]**.** This would allow agencies to search all reports made, except those

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[1031] See *Ibid.* It is not clear whose postcode was used in this instance to allocate the FTRs. For instance, what happens when a person being reported resides in Derby and the suspicious transaction was reported by a branch in Manchester, which formed a suspicion?

[1032] See KPMG. 2003. *Money laundering: Review of the Reporting Systems.*

[1033] See Fleming, M.H. 2005. *The UK Law Enforcement Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime*, University College London. http://www.jdi.ucl.ac.uk/ p.7. The assessment of FTRs were through checking them against a variety of databases, including the NCIS database known as Elmer and Alert, the Police National Computer- which keeps information of all people who had been arrested before, Her Majesty's Cedric/Centaur databases.

[1034] See *Ibid.*

[1035] *Ibid.*

[1036] *Ibid.*

[1037] *Ibid.*

[1038] *Ibid.*

[1039] See *Ibid.*

classified, i.e. terrorist financing related[1040]. The KPMG study that was conducted to assess the effectiveness of STRs in the UK tracked 600 STRs from when they were received by the NCIS to their dissemination and investigation by LEAs. It found that only "11% of the total either contributed to a successful outcome or are still being investigated"[1041]. In combining the percentage of STRs resulting in successful outcome and those still being investigated, KPMGs' finding as quoted above is even elusive as it could well be 1% (of the 11% STRs) that resulted in a successful outcome, i.e. conviction or assets forfeiture. Cases under investigation do not always result in convictions or detection of any crime. The KPMG study attributed the low success rate to a number of factors, ranging from lack of resources by investigating agencies, to poor quality of STRs, and to lack of or inadequate systems to track the outcomes of STRs.

These findings do not contradict those of a study conducted by Gold and Levi in 1994[1042], Michael Fleming's study in 2005[1043] and Hlophe's study in 2004 of the management and effectiveness of FTRs in financial investigations units of two constabularies in the UK[1044]. Since then, however, a number of changes have taken place in the UK. In July 2005, the former Chancellor of Exchequer, Gordon Brown and the former Home Affairs Secretary, Ken Clarke, asked for the review of the FTRs (SARs- as they are called in the UK) regime[1045]. This review of the reporting regime was conducted in 2006 by the then designate chairperson of the Serious Organised Crime Agency (SOCA), Sir Stephen Lander. It concluded with the incorporation of the NCIS (now called the UKFIU) into SOCA, which was launched in April 2006. The Assets Recovery Agency was similarly assimilated.

[1040] *Ibid.*
[1041] See KPMG 2003 Money laundering: Review of the Reporting Systems, p.30.
[1042] Gold, M, & Levi, M. 1994. *Money laundering in the UK: an appraisal of suspicious-based reporting*. London : The Police Foundation..
[1043] See Fleming, M.H. 2005. *The UK Law Enforcement Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime*, University College London. http://www.jdi.ucl.ac.uk/
[1044] See Hlophe, Z. 2004. *Assessing the effects of anti-money laundering regulations in the UK: Suspicious Transaction Reports and their effect in detecting money laundering*. Unpublished MSc Dissertation. University of Leicester, UK.
[1045] See Serious Organised Crime Agency. 2006. *Review of the Suspicious Activity Reports Regime (The SARs Review).* Sir Stephen Lander. March 2006. http://www.soca.gov.uk/about-soca/library/doc_download/80-lander-review-2006.

The review was to report on how 'investigations of suspicious transactions could best be pursued under SOCA'[1046]. Its terms of reference were to: 1. "review the operation of the existing SARs regime to determine its strengths, weaknesses, costs and benefits" and "to make recommendations for the future operation of the regime under SOCA, taking into account the views and interests of the regulators, the regulated sectors and the UK law enforcement agencies"[1047]. What triggered the review of the UK regime was the renewed focus there following the July 7 2005 terrorist attacks and "continuing concerns in the City and the professions about the burdens imposed" by the regime[1048]. The Lander Report, from its onset, took a defensive stance, dismissing the criticisms that were levelled at the regime by the regulated sectors in the UK. It rubbished what it called 'perceptions' of a 'broken' SARs regime[1049]. According to the Lander Report, the regulated sectors had wrongfully accused the UK government of not doing enough in investigating SARs, while they were spending millions of pounds complying with burdensome legal obligations[1050]. According to this report, some regulated sectors had further accused the regime of having produced "virtually no results in terms of crimes prosecuted and the seizure of terrorist or criminal funds as a consequence of their efforts"[1051].

The Lander Report concluded that these criticisms were inaccurate and claimed that there were successes. It however seems to have failed to substantiate these claims of success with any convincing statistics and cases. It reported that in 2005, 195,000 SARs were received and out of these, 2100 (1% of all received) were flagged as of interest for terrorist financing, and 650 were disseminated to the National Terrorist Financial Investigations Unit[1052]. It did not go further to claim any victories arising from such investigations, except to proclaim that some SARs do help. In this regard the Lander Report did not give any statistics of the outcomes of the less than 1

[1046] *Ibid.* p.1-20.
[1047] *Ibid.*
[1048] See *Ibid.*
[1049] *Ibid.*
[1050] *Ibid.*
[1051] *Ibid.*
[1052] *Ibid.* p.13-37.

percent (2100) SARs that were referred for investigation. Instead it cited "three specific 2005 AML examples...to demonstrate the kind of successes being achieved"[1053]. These pathetic three examples given in the report would hopefully not be the best of examples or the overall achievement of the SARs regime in the UK in 2005. If they were, then the regime was in limbo. The defensive tone of the report seemed to reflect a hopeless regime that was struggling to survive and withstand scrutiny. Lander's report came up with 23 Recommendations for the transformation and improvement of the regime in the UK.

At the time of writing, the Lander Recommendations were being implemented. They included the formation of a SARs Committee, referred to briefly above, which was established to independently oversee the recommended changes and to ensure the overall improvement of the regime. The SARs Committee is composed of representatives from the stakeholders of the regime: the regulated sectors, FSA, SOCA and the LEAs. The Committee has released three annual reports and has claimed some victories from the changes being effected, reaffirming the benefits of SARs for law enforcement uses.

Evolution of US's FTRs regime

In the US, the management of FTRs has undergone a number of changes since the system was put in place following the passing of the *Bank Secrecy Act (BSA) of 1970*; the first legislation in the world to introduce FTRs. FTRs in the US were initially filed with various agencies including the Internal Revenue Service (IRS), the US Treasury, several federal regulators and regional law enforcement agencies. In the late 1970s, the Congressional Committee on Banking, Finance and Urban Affairs ordered the General Accounting Office (GAO) to conduct a review of the reporting mechanisms and the uses of FTRs by law enforcement as had been envisaged in the BSA[1054]. The

[1053] See *Ibid.* for examples given.

[1054] See Government Accountability Office. 1979. *The Use of Currency and Foreign Accounting Reports to Detect Narcotic Traffickers.* United States Government Accountability Office, Washington DC

GAO conducted research, including hearings, and its findings were that the reports filed had "not been as useful as the Congress expected"[1055]. Among its proposals was that FTRs should be directed to a single agency to be located in the Treasury[1056]. The problem with sending FTRs to the IRS was that such reports could not be accessed by other law enforcement agencies due to tax law secrecy[1057].

The reports started to be sent to Treasury, which was thought to be in a "better position to conduct integrated analyses of currency flows"[1058]. This led to the formation of probably the first FIU in the world, the Report Analysis Unit, within the US Treasury. It was renamed Financial Crimes Enforcement Network (FinCEN) in 1990. Centralised FTRs were mainly those that were threshold-based (CTRs), other than the suspicion-based ones (which were referred to as 'criminal referrals') that continued to be reported to several federal law enforcement agencies[1059]. Despite this centralisation, the effectiveness and efficiency of the regime continued to be questioned, even by top US government officials.

Former US Federal Reserve Governor (1991 to 1997), Dr. Lawrence Lindsey, who has been named an outspoken critic of the AML 'war on drugs' in the US said that;

> "Between 1987 and 1995, the (US) government collected 77 million currency-transaction reports, something in the order of 62 tons of paper. Out of that, it was able to prosecute 3,000 money-laundering cases. That is roughly one case for every 25,000 forms filed. In other words, entire forests had to be felled in order to

[1055] See *Ibid.* It states that "While their improved use alone will not lead to the detection and prevention of drug trafficking and other illegal activities, it would provide responsible Federal agencies with information that could help them deal with those problems". p. 3.
[1056] *Ibid.*
[1057] *Ibid.*
[1058] Government Accountability Office. 2008. *Bank Secrecy Act: Increased Use of Exemption Provisions Could Reduce Currency Transaction Reporting While Maintaining Usefulness to Law Enforcement Efforts*. Report to Congressional Requesters, United States (February 2008).
[1059] Government Accountability Office. 2009. *Bank Secrecy Act: Suspicious Activity Report Use is Increasing, but FinCEN Needs to Further Develop and Document Its Form.* Report to Congressional Requesters, United States. (February 2009) p.11.

prosecute one case. But it gets worse: Of the 3,000 money-laundering cases prosecuted, the government managed to produce only 580 guilty verdicts. In other words, in excess of 100,000 reports were filed … [about] innocent citizens in order to get one conviction. That ratio of 99,999 to one is something we normally would not tolerate as a reasonable balance between privacy and the collection of guilty verdicts"[1060].

In the early 1990s, as shown in this quotation, there were concerns that FTRs filed with FinCEN were generally useless in detecting or solving crime. As a result of this, the Congress enacted provisions to enable regulated businesses to exempt some customers from being reported, as their reports were of 'no use' for law enforcement purposes[1061]. In 1992, the US centralised the reporting of STRs to FinCEN, by amending the BSA in the *Annunzio-Wylie Anti-Money Laundering Act of 1992*[1062]. This would help deal with the problem of 'smurfing' or transaction structuring.[1063]. Through this reform, it was envisaged that unusual or suspicious transactions which escaped threshold reporting would be detected and reported[1064]. Unlike the UK SARs, where transaction reporting could be any amount of money, even £1 as held by Justice Colman in the *P v P* case[1065], the US has some thresholds for STRs. Requirements set were that STRs must aggregate to at least US $5,000 for them to be reported[1066]. Around the mid-2000s, Congress instructed further research regarding the effectiveness and efficiency of FTRs. Concerns of the early 1990s of over-reporting had not dissipated when it came to CTRs.

[1060] Cited in Richard W Rahn Conference Presentation 30 January 2001.

[1061] See Government Accountability Office. 2008. p. 2. These exemptions would be done through the US's Money laundering Suppression Act of 1994 and exemptions under it. Exemptions were promulgated for customers that are depository institutions, government entities or institutions exercising some government authority, companies that are listed on any of the US' stock exchanges (listed companies and subsidiaries that are 51 percent or more owned by a listed company, other business customers that frequently engage in large cash transaction or may not derive more than 50 percent of their gross revenue from activities or lines of business specifically deemed ineligible, such as sale or purchase of automobiles or gaming etc.).

[1062] Government Accountability Office. 2009. p.11.

[1063] *Ibid.*

[1064] *Ibid.*

[1065] *P v P* [2003] EWHC Fam 2260, www.bailii.org.uk.

[1066] Government Accountability Office. 2009. p.11.

Two reports were produced by the GAO in response to the Congress's request -- one looking specifically at CTRs[1067] and the other at STRs[1068]. For CTRs, the review was conducted to assess: the obligations and costs imposed by regulation on regulated businesses, the usefulness of CTRs for crime combating purposes and ways to encourage regulated businesses to use regulatory "exemptions to avoid unnecessary CTRs"[1069]. This latter objective of the review reported on the concerns about the FTR regime's inefficiencies and costs. These regulatory exemptions, which were introduced in the US in 1992, had not worked as businesses saw them as adding more costs due to their requirements[1070]. The regulated businesses were on an annual basis required to fill in and file forms for all eligible customers in order to excuse them for reporting CTRs that were seen to be of no use to law enforcement purposes. They were also expected biannually to update this exemption information to ensure that exempted customers still qualified[1071]. This added more bureaucracy for regulated businesses to the extent that they could as well file all CTRs in order to avoid any confusion[1072]. For instance, some of the concerns raised by the interviewed businesses pointed to some lack of clarity about the appropriate documentation that was required to exempt customers and their fears that they could be fined for non-compliance if the exemptions filed were incorrect[1073].

In the year ending in 2009 FinCEN had more than 180 million FTRs in its database, collected over the years. It also had 14.9 million and 1.8 million CTRs and STRs, respectively, collected in 2009 alone[1074]. GAO's STRs report was conducted with similar concerns of 'over-reporting', quality and usefulness of STRs[1075]. Its findings on the causes of over-reporting were, among others, the fear of sanctions by regulated businesses after several well-publicised regulatory

[1067] See Government Accountability Office. 2008.
[1068] Government Accountability Office. 2009.
[1069] See Government Accountability Office. 2008.
[1070] See *Ibid.* p.6-7.
[1071] *Ibid.*
[1072] *Ibid*.
[1073] *Ibid*
[1074]*Financial Crimes Enforcement Network Annual Report 2009*. http://www.fincen.gov/news_room/rp/files.
[1075] Government Accountability Office. 2009. *supra.*

enforcement fines on a number of big banks and other institutions were imposed. As Fred Godwin[1076], quoted above, noted the AML compliance fines were "draconian" and that a bank might be best off simply reporting every transaction[1077]. Having reviewed the evolution of these reporting regimes in the US and the UK, we now look at South Africa's reporting regime.

South Africa's FTRs regime

South Africa's FTRs regime has not been dramatic as yet. There has, as mentioned above, been only one plea-bargained conviction for non-compliance with the FICA regulations. There have been no studies conducted in South Africa to assess/review the effectiveness and efficiency of the regime by academics, the FIC or government, except for the Mutual Evaluation Report published by the FATF in 2009. We draw heavily on the data presented in this Mutual Evaluation Report and the FIC's annual reports. We also draw from interviews with regulated businesses (mainly banks) and supervisory bodies to law enforcement officers (investigators and prosecutors) and other private sector experts with an interest in AML/CTF and crime prevention issues in South Africa. This variety of sources helps us to fill some gaps and to corroborate various accounts-given that attempts to talk to the FIC and the Department of Finance were not successful[1078].

Above, we have discussed the provisions of FICA pertaining to the requirements for the reporting of FTRs and for access to information held by regulated businesses, supervisory bodies,

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[1076] http://en.wikipedia.org/wiki/Fred_Goodwin. By the way, it was under "Sir Fred the Shred", as Godwin is affectionately known, that the Royal Bank of Scotland almost collapsed and was saved by the government, while he retired with a 'platinum handshake' which incensed some taxpayers to break his house's windows in Edinburgh in March 2009

[1077] The Daily Telegraph: 23 December 2003 cited in Hlophe, Z. 2004. *Assessing the effects of anti-money laundering regulations in the UK: Suspicious Transaction Reports and their effect in detecting money laundering*. Unpublished MSc Dissertation. University of Leicester, UK.

[1078] Interviews were arranged and agreed to with the Department of Finance. However on arrival, we were informed that the Ministry of Finance does not participate in academic research conducted by students. We were taken aback by this backward stance. But this is not the way in which the government of South Africa, in general, views participation on academic studies, perhaps not even the Department of Finance. We managed to secure interviews with very high level officials from various government and semi-government institutions of South Africa without the hiccups experienced at the Department of Finance. The private sector was also very cooperative.

and the South African Revenue Services by the FIC. With those issues discussed, we now turn to examine the FIC statistics and to evaluate whether there are any differences when it comes to successes of the South African reporting regime, as compared to UK and US cases which we just discussed above. In this comparison we do not seek unfairly to compare South Africa to these two countries given that their reporting regimes were set up more than 20 (in the UK) to 40 (in the US) years ago. We merely seek to tell a story of South Africa's reporting regime and its outcomes since the FIC was set up in 2002. Most of the statistical data used here cover the period between 2002 and 2008. Some major issues highlighted by research are that FIUs should have enough powers and capacity to manage the AML regulatory regime to ensure its effectiveness. This means, among other things, that they must have the necessary powers, mandate, staff and resources to perform their functions. In this regard we start with FIC resources.

Budget allocations, resources, and structure of the FIC

Between 2003 and 2010, the FIC has continuously received very generous budget allocations to enable it to perform its functions. In its annual reports, the FIC has itself shown some satisfaction on the budget allocations and has grown to employ more than 140 personnel in 2010, compared to just about 20 when it started operating in 2003. One of the major problems the FIC has identified is its failure to attract appropriately qualified or skilled personnel – a problem that it claims has delayed its recruitment drive[1079]. For instance in 2009/10, it approved 108 vacancies and was only able to fill 30 percent (32) of them[1080]. The Auditor-General's report also shows that the FIC under-spent its previous year's allocated budget by more than ZAR 15 million[1081]. There were also concerns from the Auditor-General of unauthorised or irregular expenditure which

[1079] *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, pp.6-16.
[1080] *Ibid.*
[1081] *Ibid.*

resulted in its Chief Financial Officer being suspended and another staff member being criminally charged[1082].

The FIC Director, Mr. Murray Michel, attributed the FIC's under-spending to "cost-saving measures and sound financial decision making", and to "slower-than-anticipated progress to complete" the implementation of its "business continuity programme"[1083]. The FIC is headed by a Director who is appointed by the Minister of Finance for a renewable period of five years. The Director is the accounting authority of the FIC and reports directly to the Minister of Finance and to Parliament for the Centre's performance[1084]. The FIC has three main operational units: the Legal and Policy Unit, Compliance and Prevention Unit and the Monitoring and Analysis Unit. It also has the Administration and Support Services Unit. The Legal and Policy Unit is responsible for administering FICA, maintaining liaison and strategic cooperation with "international and regional organisations such as the FATF and ESAAMLG" and policy advice concerning improvement of South Africa's AML/CTF strategies[1085].

The Head of this Unit is Pieter Smit, the former South African Law Reform Commission (SALRC) researcher who drafted the initial FIC Bill for SALRC's Project 104 that we referred to in *Chapter 5*. The Compliance and Prevention Unit oversees compliance by regulated businesses with FICA[1086]. In this regard it issues guidance notes and provides training to regulated businesses, law enforcement and other affected institutions. It is also its task to enhance the general public awareness of the country's AML/CTF measures to encourage public compliance with such programmes as KYC[1087]. The Monitoring and Analysis Division is responsible for receipt, analysis and dissemination of FTRs to LEAs. It is the work of this latter division that the remaining parts of this Chapter address.

1082 *Ibid.*
1083 *Ibid.*
1084 *Ibid.*
1085 *Ibid.*
1086 *Ibid.*
1087 *Ibid.*

The outcomes of FTRs in South Africa

Although FICA legislated for CTRs and STRs, from 2002 to 2010 the FIC only administered the STRs regime during that period. The CTRs were only phased in during 2010. FICA took over the FTRs reporting regime from the Commercial Crimes Branch of the SAPS, where these were previously reported under POCA, as discussed above.

TABLE 7.1: STRs reported to the Commercial Crimes Branch of the SAPS 1997-2002

Year	**Number of STRs**
From May 1997	140
1998	191
1999	347
2000	682
2001	1004
To May 2002	635
Total	2999

Source**:** Reconstructed by author from De Koker, L. 2002. *Money laundering in South Africa*. Centre for the Study of Economic Crime. Rand Afrikaans University: Johannesburg.

Not much is known about the administration of the reporting regime under POCA except that FTRs were made to the Commercial Crimes Branch. There are, however, some statistics that relate to numbers of cases filed prior to the formation of the FIC. They cover the period between May 1997 and May 2002. During the POCA-SAPS dispensation, there were very few money laundering convictions recorded in South Africa, perhaps only 2 in all[1088], and they may not have resulted from the STRs[1089].

Between 1997 and 2003, only 41 criminal investigations were initiated as a result of STRs[1090]. These 41 investigations had by 2003 led to 5 criminal convictions for offences other than money laundering[1091]. The FIC has been receiving a fair number of FTRs per annum since May 2002. These statistics have been presented in the Financial Action Task Force's Mutual Evaluation Report on South Africa, published in 2009. Below we analyse these statistics to determine the outcomes of the reporting regime in South Africa between 2002 and 2008. The information flow process of the STRs regime is as follows. Regulated businesses report to the FIC. The FIC, on receiving STRs, is supposed to analyse them and to use its discretion to decide whether to disseminate them to LEAs or file them in its database for possible future use, if at all.

When it decides to make referrals, the FIC forwards them to the end users, which are the AFU, SAPS, DSO (prior to disbandment), SARS, ExCon, NIA and SASS. Alternatively, these designated agencies, as discussed earlier above, can request the FIC to send them specific FTRs which may relate to their ongoing investigations. Between 2003 and 2008 the FIC sent 2510 (1919 referrals, 470 requests, and 121 Counter Terrorist Financing (CTF) referrals) FTRs to its end users. CTF referrals only started in 2007 (11 STRs) and increased to 110 in 2008. All these disseminated STRs resulted in 184 investigations, 79 of which were closed/finalised and 105 were still ongoing at the end of 2008. Out of these 184 investigations, 17 arrests were made, resulting in 4 criminal

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[1088] *Author Interview with Adv. Willie Hofmeyr*. Adv. Hofmeyr says one of these money laundering convictions emanated from the *Bathgate* matter in Cape Town and was prosecuted by adv. Billy Downer. Another one concerned the R31 million armed robbery case and was prosecuted by Adv. Anton Steynberg in KwaZulu-Natal. Both Adv. Billy Downer and Adv. Anton Steynberg went on to prosecute one of the most publicised cases in South Africa history, the *S v Shaik and Others* where Jacob Zuma's erstwhile financial advisor Shabir Shaik was convicted and implicated Zuma in the arms deal related corruption. For more on the arms deal See Holden, P. 2008. *Arms deal in your pocket*. Cape Town: Jonathan Ball Publishers. See also Crawford-Browne, T. 2007. *Eye on the money*. Cape Town: Umuzi Publishers.

[1089] See International Monetary Fund. 2004. *South Africa: Report on the Observance of Standards and Codes-FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*. IMF Country Report No. 04/119, April 2004, Washington DC p.3.

[1090] *Ibid.*

[1091] *Ibid.* p.3.

convictions on charges of money laundering and 1 conviction each year between 2004 and 2008. None of these arrests and criminal convictions were counter-terrorist related[1092]. This low arrest and conviction rate of FTRs is appalling, to say the least, given the huge but yet unspecified costs of the regime. A general defence advanced by FIUs for these low achievements of the regime is that LEAs do not provide feedback on how STRs have helped them or not.

TABLE 7.2: FIC statistics between 2003 to 2008

Suspicious Transaction Reports	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	***Total***
Received by FIC[1093]	993	7480	15757	19793	21466	24580	***90069***
Referred to LEAs [1094]	-	36	134	191	559	999	***1919***
Requested by LEAs[1095]	-	4	6	7	232	221	***470***
Ongoing investigations[1096]	-	3	12	25	13	52	***105***
Finalised investigations[1097]	-	17	19	35	6	2	***79***
Arrests[1098]	-	3	5	8	1	0	***17***
Convictions[1099]	-	0	1	1	1	1	***4***
CTF related referrals[1100]	-	0	0	0	11	110	***121***
LEA feedback to FIC[1101]	-	26	43	76	253	276	***674***

Source: FATF. 2009. *Mutual Evaluation Report: South Africa.* FATF, OECD, ESAAMLG: Paris, pp.67-69. Reconstructed by author.

However in the South African case, as shown in the table above, LEAs are providing this feedback to the FIC. For the 2510 STRs disseminated between 2003 and 2008, the FIC got 647

[1092] FATF. 2009. *Mutual Evaluation Report: South Africa.* Paris: FATF, OECD & ESAAMLG.
[1093] These are STRs received by the FIC from regulated businesses.
[1094] STRs referred by the FIC to LEAs. These STRs are not related to terrorist financing, but money laundering and other predicate offences which are not related to terrorism.
[1095] STRs referred to LEAs on request by LEAs.
[1096] These are investigations opened and were still ongoing by the LEAs after receiving STRs from the FIC.
[1097] STRs which have been investigated and either amounted to arrests or no arrests, but do not form part of active investigations.
[1098] Arrests made by LEAs following from STRs they received or requested from the FIC.
[1099] Convictions achieved made by LEA following from STRs they received from the FIC.
[1100] Counter-terrorist financing STRs disseminated by the FIC to LEAs.
[1101] Feedback from LEAs to the FIC on progress made on STRs received/requested.

updates from LEAs. Within LEAs, referrals are sent to 'authorised officers'[1102]. The latter is a liaison point between the FIC and specific law enforcement agencies. This is done for security reasons, to preserve the trail and to protect information. For instance the AFU would have two 'authorised officers' in each of its offices across the country[1103]. When the AFU or other LEAs need information from the FIC, they would ask an authorised officer to send and receive such information.

According to the FIC, when it receives a request from anyone other than an authorised officer, it would not comply with such a request until it is sent through the formal channels of authorised officers of an LEA[1104]. When the FIC sends this information back to an investigating agency, such a referral must be authorised by the FIC Director or a senior manager authorised by the Director[1105]. On receipt of a referral, an LEA must file an acknowledgement of receipt form[1106]. This process seems to preserve an audit trail of information flow between the FIC and LEAs. This process could also be used to feedback to the FIC on the outcomes of these referrals. Whether it is through authorised officers or not, the statistics in the table (Table 7.2.) above show that there is a fair level of feedback provided by LEAs to the FIC to get an idea of what is happening. The complaint that LEAs do not provide feedback would therefore not be plausible in the case of South Africa. Whereas the reporting regime is the centre of outputs of the overall AML/CTF regime, at the rate of arrests and convictions, South Africa's regime cannot be said to be achieving its goals.

[1102] *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, pp.6-16
[1103] *Author Interview with Adv. K. Molelle, October 2009.*
[1104] See *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, pp.6-16.
[1105] *Ibid.*
[1106] *Ibid.*

When the reporting regime fails to produce convictions, we can safely conclude that it is failing to achieve one of its primary goals of detecting and combating crime so far. Therefore it can be said to be ineffective and also inefficient. The other incidental goal of the AML/CTF regime that is little discussed is the protection of the financial system from abuse by criminals and terrorists. The achievement of this latter goal could only be substantiated when money launderers and terrorists are actually found through the filing of FTRs. If it does not yet find these enemies of the financial system in South Africa, then the regime loses its output legitimacy claims. It would be difficult to advance an argument about protecting the integrity of the financial system against threats and enemies that the regime is dismally failing to expose. Not that the situation is different elsewhere. Arrests, convictions and asset forfeiture orders that are directly attributed to FTRs appear to flow from only a tiny fraction of the reports that these FIUs receive from regulated businesses.

Our submission is that while there is some money laundering being uncovered, and such assets are being seized and forfeit, all these successes cannot or can barely be attributed to the filing of FTRs. For instance, statistics from the South African Police Services' CAS system[1107] show that between 2003 and 2008, 64 cases with a money laundering charge were registered[1108]. Out of those cases, only 16 money laundering convictions were achieved; 3 in 2005 and 13 in 2008[1109]. A total of 15 of these 64 cases were pending before the courts and several other cases could have had the offence of money laundering added in the charge sheet because of the nature of the crimes[1110]. Work from the Special Commercial Crimes Unit[1111] also shows that cases of

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1107 The South African Police Service's CAS system is the database of all cases and investigations registered in the national police database.

1108 FATF. 2009. *Mutual Evaluation Report: South Africa.* Paris: FATF, OECD & ESAAMLG, p. 36.

1109 *Ibid.*

1110 *Ibid.*

1111 The Special Commercial Crimes Unit was established by the National Prosecuting Authority in 2002 to work closely with the South African Police Service's Commercial Crimes Branch in prosecuting Commercial Crimes in South Africa. As a result of this initiative, Special Commercial Crimes Courts were established in the major centres of South Africa to prosecute mainly cases emanating from the Commercial Crime Branch of the SAPS.

money laundering are receiving a lot of attention and have been successfully prosecuted[1112]. Also, the AFU appears to be doing a lot of work in seizing assets using Chapter 5 and 6 of POCA.

Statistics reflect that between 2002 and 2008 April, the AFU successfully obtained 1070 freezing orders amounting to a monetary value of just above ZAR 2, 4 billion[1113]. Out of these freezing orders, the AFU successfully got 926 orders with just below ZAR 700 million (ZAR 697, 951,372.42) of criminal assets forfeit. About ZAR 560 million of the ZAR 700 million, resulted from 389 confiscation orders. Confiscation orders are, roughly, granted as a result of a criminal conviction of accused persons or entities for an offence (s) from which they derived a benefit[1114]. The AFU statistics only reflect the broader categories of predicate crimes such as corruption; economic crimes; drug related offences; gambling; precious metals and stones; violent crimes such as cash in transit heists; robberies and racketeering[1115].

There could well have been money laundering convictions for most of the cases where confiscation orders were achieved, but the AFU did not record this in its statistics[1116]. In all the broader crime categories mentioned in the AFU statistics, all these offences where criminal assets were forfeit, an offence of money laundering could, arguably, have been part of the charges, but was not pursued, perhaps, in favour of more familiar offences such as fraud, theft, robbery, etc. This view was shared also by Susan Coetzee of SABRIC that

> "…there are very few commercial crime cases where there is not an opportunity to add money laundering charges. The reality is that there is a lot of work to be done to actually encourage a paradigm shift, to get the money laundering charges used."[1117]

[1112] See FATF. 2009. *Mutual Evaluation Report: South Africa.*Paris: FATF, OECD & ESAAMLG, p. 37-40, for a list of cases of money laundering that have been prosecuted by the Special Commercial Crimes Court.
[1113] See Table 7.3.
[1114] See Chapter 4 above for a discussion of confiscation orders.
[1115] See FATF. 2009. *Mutual Evaluation Report: South Africa.* Paris: FATF, OECD & ESAAMLG. p.49-50.
[1116] See TABLE 7.3 for the different types of offences mentioned.
[1117] *Author Interview with Susan Coetzee of SABRIC, October 2009*

This may reflect a need for more training for investigators and prosecutors to start encouraging them to use these new organised crime instruments for, among others, the heavier penalties that they provide for and to develop the law. Susan Coetzee did mention that SABRIC was on a drive

> "…to identify money laundering cases and to encourage the prosecutors to add a money laundering charge to the charge sheet"[1118]

It appears that South Africa may not be achieving money laundering convictions simply because investigators and prosecutors are still grappling with these new laws and may need to be encouraged to start using the provisions of POCA in order to achieve them rather than relying on the popular predicate offences of money laundering. About ZAR 138 million of the ZAR 700 million forfeit was the outcome of *in rem* proceedings which resulted from 535 forfeiture orders[1119].

TABLE 7.3: AFU Orders between 2003 and 2008

POCA Freezing & Restraint Orders	**Total No.**	**Chapter 5**	**Chapter 6**	**Chapter. 5**	**Chapter. 6**
Corruption	74	44	30	ZAR 183,114,529.78	ZAR 10,602,684.14
Economic Crime	566	316	250	ZAR 1,797,700,094.18	ZAR 207,494,571.13
Drug Dealing	126	26	100	ZAR 40,084,898.40	ZAR 42,434,740.63
Drug House	15	0	15		ZAR 4,086,641.65
Drug Money	84	3	81	ZAR 826,193.74	ZAR 11,198,815.27
Car (majority Chpt 6)	8	1	7	ZAR 102,145.00	ZAR 363,000.00
Brothels	3	0	3		ZAR 1,030,100.00
Gambling	2	0	2		ZAR 1,042,655.19
Precious Metals and Stones	24	4	20	ZAR 9,082,000.00	ZAR 4,326,844.05
Natural Resources	142	7	135	ZAR 3,805,881.00	ZAR 21,063,575.30
Violent Crime	24	10	14	ZAR 7,986,226.00	ZAR 4,812,331.00
Racketeering	2	2	0	ZAR 60,000,000.00	
Total	**1070**	**413**	**657**	**ZAR 2,102,701,968.10**	**ZAR 308,455,958.36**

1118 *Ibid.*
1119 See Chapter 4 above on the different asset forfeiture orders in South Africa.

POCA Confiscation/ Forfeiture Orders	**Total No.**	**Chapter 5**	**Chapter 6**	**Chapter 5**	**Chapter 6**
Corruption	62	34	28	ZAR 110,163,460.67	ZAR 6,005,783.77
Economic Crime	486	293	193	ZAR 269,524,845.03	ZAR 84,746,422.71
Drug Dealing	94	18	76	ZAR 10,194,194.56	ZAR 13,153,204.13
Drug House	12	0	12		ZAR 2,118,605.92
Drug Money	79	5	74	ZAR 121,700,874.00	ZAR 11,039,238.06
Car (majority Chpt 6)	3	0	3		ZAR 65,000.00
Brothels	2	0	2		ZAR 730,100.00
Gambling	2	1	1	ZAR 1,419,209.00	ZAR 42,655.19
Precious Metals and Stones	16	4	12	ZAR 9,027,000.00	ZAR 1,128,214.05
Natural Resources	151	26	125	ZAR 35,728,640.82	ZAR 17,665,232.80
Violent Crime	16	7	9	ZAR 1,535,631.71	ZAR 1,763,060.00
Racketeering	1	1	0	ZAR 200,000.00	
Total	**924**	**389**	**535**	**ZAR 559,493,855.79**	**ZAR 138,457,516.63**

Source: FATF. 2009. *Mutual Evaluation Report: South Africa*. FATF, OECD, ESAAMLG: Paris, pp.49-50. Reconstructed by author.

All this information and statistics from the SAPS CAS system, Commercial Crimes Unit and the AFU shows that a number of actual or potential money laundering cases are being prosecuted in South Africa and there are some successes being recorded. However, very few of these successes are yet attributed to the enactment of FICA and the establishment of the FIC, particularly the reporting of customer transactions. Some of the successes might well have had ‘referred’ or ‘requested’ FTRs contributing; perhaps without these LEAs noticing or properly recording such contributions. This is simply because FTRs are just one source of information out of many other sources that LEAs use for evidence gathering purposes[1120]. For instance, LEAs may

[1120] This point is also made in the GAO report with respect to the US where LEAs make use of many sources of evidence without having to provide any feedback. See United States Government Accountability Office (2008) Bank Secrecy Act: Increased Use of Exemption Provisions Could Reduce Currency Transaction Reporting While Maintaining Usefulness to Law Enforcement Efforts, Report to Congressional Requesters (February 2008) p.6-7.

receive some relevant information from the FIC, but they still need to subpoena such information from its original source; perhaps from a bank or other regulated institution.

This means that if a bank reports an FTR and the FIC sends it over to an LEA, the investigating officer still has to subpoena the original documents from the reporting bank for court purposes. The process of collecting original documentary evidence becomes even more cumbersome when the FTRs referred to LEAs are intended to initiate new investigations. For new investigations, the police, for instance, need to open a docket. One officer explained to me that

> "...it is not possible for us to actually do an investigation, unless we open a docket. The FIC perhaps do not understand just what is involved in opening a docket. Their suspicious transaction reports are a folio...They can send you reams and reams and reams and reams of suspicious transactions from their computer system, but there is no manpower to go and look up everyone of them, to investigate them...Those are not dockets yet. You have to take them, go and approach the banks and say "look, you reported a suspicious transaction to the FIC, can we have more information." They say "we want a 205[1121]"...Then you would have to take that suspicious transaction back to your office, you open a docket, you prepare a section 205 notice, you take it to the prosecutor, the prosecutor signs it, you take it to the magistrate, the magistrate authorises it, serve it on the bank and you wait for six weeks before you get the information. Then you find that it was a businessman who transferred money to his wife's account and it was really not so suspicious after all".

[1121] '205' stands for the subpoenas used by the police to acquire documents or evidence in terms of section 205 of South Africa's Criminal Procedure Act of 1977. Investigators used the section 205 notice to subpoena bank statements, telephone bills and other documents from the relevant service providers.

This false positives situation, on top of skewing crime statistics, may in a way lead LEAs to place little value on FTRs. After investigating a couple of reports which turn out to have been legitimate transactions some investigators may start to give them less priority.

Section 34 Interventions

In its 2009/10 annual report, the FIC revealed that it received 29, 411 FTRs and only referred 331, compared to the 1330[1122] that were sent to LEAs in 2008[1123]. The decline in the number of referrals, according to the FIC, is due to its "new approach that takes into account the priorities, capabilities and human resource constraints facing different law enforcement agencies"[1124]. We could therefore assume that were it not for these constraints, the FIC would be referring more FTRs to LEAs for investigations. There is another excuse or justification for the diminished numbers of referrals. It is the FIC's "substantially increased...ability to interpret and identify money laundering schemes, proceeds of crime and potential terrorism financing."[1125] As a result of this "improved data analysis, law enforcement agencies are now better positioned to act on reports that we supply"[1126], the FIC claimed.

The FIC further claimed that its improvements in analysing FTRs were also due to the improved quality of data, rather than quantity. To this end, the FIC showed that although the number of FTRs referred to LEAs declined by 79% in 2009/2010, the monetary amounts in the 331 referred reports increased to ZAR 61.6 billion, as compared to ZAR 5.6 billion (of the 1330 referred FTRs) a year earlier. The FIC appears to use these big amounts in a rather creative way in its annual reports. For instance as a result of this increase in the monetary amounts of these referred

[1122] This includes the 999 AML and 110 CTF referrals and 221 STRs sent by the FIC to LEAs following LEA requests in 2008.
[1123] See *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, p. 14-15.
[1124] *Ibid.* p. 28.
[1125] *Ibid.*
[1126] *Ibid.*

FTRs, we may be led to believe that such big amounts end up being seized and forfeit. It would not be surprising to find that most of these amounts probably do not end up being linked to crime. They may just be mere suspicious transactions which, in the majority, do not amount to the detection of money laundering or terrorist financing. Let us look more closely at the amounts that ended up being frozen, using the FIC's section 34 intervention[1127] to demonstrate this point.

While ZAR 61.6 billion FTRs were identified and referred to LEAs as suspicious, the FIC only managed to use its section 34 interventions on '43 matters' (of the 330 referred FTRs in 2009/10 financial year) resulting in the freezing of ZAR 128 million "in the bank accounts of those involved"[1128]. This amount (ZAR 128 million) is substantially smaller than the ZAR 61.6 billion identified and referred to LEAs in 2009/10. There may well still be more freezes of this monetary value (ZAR 61.6 billion) of referred FTRs, but such freezes are merely meant to enable the AFU to bring court action before such moneys are depleted or transferred to other accounts or laundered. Even the amounts frozen (ZAR 128 million) do not necessarily mean that all frozen funds end up being forfeit by the AFU[1129]. It simply means that the owners of such frozen assets still have a chance to challenge the freezing orders. However, when the FIC declares its victory in freezing assets, it has often not reported in its subsequent annual reports on how much of those frozen funds ended up being forfeit[1130]. We can look at the previous years' freezes to substantiate this point. For instance, between 2005/06 and 2007/08 financial years, the FIC used section 34 interventions on 11 matters, amounting to over ZAR 7,6million, This represents just above ZAR 3,3million in 2005/06, ZAR 1,5 million the following year and ZAR 2, 7 million in 2007/08.

[1127] Section 34 of FICA allows the FIC to intervene by temporarily freezing funds suspected/ known to be proceeds of crime in bank accounts or possession of regulated businesses. See discussion of Section 34 intervention above.

[1128] See *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, p. 14-15.

[1129] Section 34 of FICA allows the FIC to freeze such transactions for 5 days, while the Asset Forfeiture Unit (see discussion later and more on Chapter 4 of this thesis) applies for permanent freezing or confiscation orders using Chapter 4 or 5 of the Prevention of Organised Crime Act of 1998.

[1130] In *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, p.30, the FIC reported the "...we froze bank accounts and worked with other government agencies to confiscate the financial benefits of criminal activity. The FIC froze just over R128 million in bank accounts to enable investigators from the Asset Forfeiture Unit to forfeit the amounts." This vagueness of the FIC report makes it difficult to discern whether such frozen amounts were all forfeit in the end or not.

TABLE 7.4: Section 34 Interventions by the FIC between 2005/06 and 2007/08[1131]

Year	No. of Interventions	Amounts Frozen
2005/06	3	ZAR 3,365,724.94
2006/07	4	ZAR 1,546,127.31
2007/08	4	ZAR 2,700,000.00
Total	11	ZAR 7,611,852.25

Source: FATF. 2009. *Mutual Evaluation Report: South Africa*. FATF, OECD, ESAAMLG: Paris

While 2009/10 amounted to ZAR 128 million, a substantial increase over the assets frozen (ZAR 7,6 million) through section 34 intervention between 2005 and 2008 (as shown in Table 7.4 above), the FIC does not report whether the latter freezes ended up in forfeiture or not. Freezing amounts and reporting that they have been does not translate automatically into them being forfeit. Below we look at how the FIC has been using its other instruments such as section 27 'discovery of information' and section 32 'further information requests'[1132].

Discovery of Information and Further Information Requests

Between 2005 and 2008, the FIC made about 4000 section 27 'discovery of information requests' to regulated businesses[1133] and just over 1500 section 32 'further information requests'. The South African Banking Risk Centre (SABRIC), an organisation set up by South African banks in 2002 to assist them in the analysis and prevention of bank related crimes, also has a similar facility where investigating agencies can request information leads before they send out subpoenas[1134]. We asked compliance officers in banks whether they felt the FIC ever acted on the STRs they send to it. All of them felt that the FIC does take some action, although they are not informed of the ultimate outcomes of the reports they make.

[1131] FATF. 2009. *Mutual Evaluation Report: South Africa.* Paris: FATF, OECD & ESAAMLG. p.62.
[1132] See discussion of these provisions above.
[1133] FATF. 2009. *Mutual Evaluation Report: South Africa.* Paris: FATF, OECD & ESAAMLG.
[1134] Interview with Susan Coetzee of SABRIC October 2009.

> “Yes they do, because they ask us for further information on the reports we submit. They often ask for additional information. We often get a lot of section 27s asking whether we bank this customer and that can only be as a result of some other bank reporting a matter as suspicious. And we get a lot of that, sometimes 20, 30 a day. So it depends, but the average is 10 of those requests [a day]. But we also get a fair amount of freezing orders and those sorts of things. The question is yes there is work being done at the FIC.”[1135]

Another compliance officer in another bank echoes similar sentiments.

> “I find that they do, because a lot of time you find that things that are reported over to the FIC, like, let’s say, we report Mr. Smith today to the FIC, you might find in three weeks’ time the Commercial Crimes Unit of the SAPS...gives us a subpoena for Mr. Smith’s documents, which obviously means that it has come full circle”[1136]

However, the FIC does not normally give feedback to regulated businesses on whether the STRs have helped in uncovering criminality or not. There is a sense that the FIC should give some feedback to these institutions. Others felt that this feedback was not so necessary. Those who felt that feedback is necessary pointed out that it may help them to refine and improve their systems.

> “That is the kind of feedback we could use to do statistical analysis on our side and to understand whether or not our system needs improvement. We do not know whether our analysts are properly trained, whether we are looking for the right things. It would be very helpful (to get some feedback).”[1137]

Feedback is an important issue with FTRs. The issue of the FIC not providing feedback was also raised in the FATF’s Mutual Evaluation Report on South Africa as earlier quoted. But

[1135] *Author Interview with Compliance Officer (October 2009).*
[1136] *Author Interview with Compliance Officer (October 2009).*
[1137] *Author Interview with Compliance Officer (October 2009).*

what the FATF referred to was not feedback to each and every institution for each FTR that is reported. The reference to feedback seems to be much more on providing sanitised cases that were solved through FTRs. The view is that such typologies help to assure reporting institutions that these FTRs do work and to encourage reporting and cooperation, as argued in the Lander report we referred to above[1138]. Banks and other financial institutions accounted for over 90% of FTRs filed with the FIC in 2009/10 financial year[1139]. This trend has remained the same over the years with non-financial regulated entities such as lawyers, estate agents and others accounting for the other approximately 10% of all the FTRs made to the FIC[1140]. It is important that while banks account for a large number of FTRs made to the FIC, not all types of banks report. According to Ms. Lerato Mokhesi of the Banking Supervision Division (BSD) of the SARB, while banks report FTRs to the FIC, they also send information to the SARB which is their supervisory body under FICA. According to her, branches of foreign banks tend to report far less than the local retail banks because of the nature of their business[1141].

Is South Africa starting to see the results of the reporting regime? There are mixed views within the LEAs as to the benefits of FTRs. Some are of the view that the presence of the FIC and its FTRs has added some value in solving crime. Others were however of the view that the FIC

[1138] See also Appendix 7.1.
[1139] See *Financial Intelligence Centre: Annual Report 2009/2010,* Republic of South Africa, Centurion, p.29.
[1140] *Ibid.*
[1141] *Author Interview with Lerato Mokhesi of the SARB, 21 October 2009.*

Author (ZH): Are you getting any trends of banks who are reporting less than others?
Lerato Mokhesi (LM): Most of them just give us a nil return.
ZH: On a monthly basis?
LM: Yeah, they report on a monthly basis.
ZH: Does it happen that one bank would not report a suspicious transaction for the whole month?
LM: For the whole year.
ZH: For the whole year?! What kinds of banks would be those, what kinds of activities or business are they involved in?
LM: Branches of foreign banks…I think the number of suspicious reports that a bank would report depends on the activities of that bank. A bank that does retail banking would report more than a bank that concentrates on tranche finance and other things.

was still establishing itself and it was too early to expect any substantial benefits. It appears that LEAs are encouraging investigators to request information regarding their ongoing investigations from the FIC. This practice, however, may still need to be internalised by LEAs and be made official policy so that for each and every relevant serious profit-driven crime investigation, FIC intelligence is requested at the early stages. It is not clear whether such a practice has been internalised within the LEAs or not.

TABLE 7.5: Requests made by LEAs to the FIC between 2005 and 2008

Year	AFU	DSO	SAPS	NIA	SARS	SASS	Totals
2005/06	77	32	91	1	5	1	***207***
2006/07	128	37	101	12	5	7	***290***
2007/08	185	43	52	27	20	0	***327***
Total	390	112	244	40	30	8	***824***

Source: FATF. 2009. *Mutual Evaluation Report: South Africa*. FATF, OECD, ESAAMLG: Paris, p.62

Within the now disbanded DSO, according to some study participants, this practice was starting to be internalised. The AFU also seems to have done the same. Statistics from the FIC also show that LEAs are proactively making such requests. A total of 824 such proactive requests were made by agencies between 2005 and 2008 (see Table 7.5). In response to these requests, the FIC disseminated 628 information packages to the agencies as listed in Table 7.6. It appears from these data that the AFU sent and received more information packages proactively as compared to the other agencies. AFU's mandate enables it to work with different agencies in ensuring that all proceeds and instrumentalities of crime are seized and forfeit.

TABLE 7.6: Intelligence packages disseminated following requests by LEAs

Year	AFU	DSO	SAPS	NIA	SARS	SASS	Totals
2005/06	62	21	68	1	3	1	**156**
2006/07	122	33	92	10	5	5	**267**
2007/08	126	19	30	13	17	0	**205**
Total	**310**	**73**	**190**	**24**	**25**	**6**	**628**

Source: FATF. 2009. *Mutual Evaluation Report: South Africa*. FATF, OECD, ESAAMLG: Paris, p.62

This information supplements the ordinary referrals discussed above. The information contained in the intelligence packages is generally not raw FTRs, but processed information. As one investigator explains:

> "They (the FIC) will give you a comprehensive report. The report would contain all the bank accounts that are held by your subjects, the regular deposits that are made into those accounts, by whom. And if that particular subject has got other business interests...they will give you information about all his business interests, his associations if he is director of a certain entity...If other institutions have made inquiries about your subject, they would give you that data as well."[1142]

When the FIC finally refers or disseminates reports to LEAs, it is no longer raw FTRs but processed information or intelligence. This has implications for the FIC's governance since it is not necessarily an intelligence organization. While there was a general view among our interviewees that the information they received from the FIC was useful in providing a general overview about the subjects being investigated, there was also a sense that the intelligence packages provided by the FIC were useful mainly in ongoing investigations rather than in initiating new ones.

As one officer says;

> "I never used to get any cases (that were initiated by FTRs). What happened was- If I am investigating certain subjects, I would then have to log a request with the FIC to find out if they had received any reports about any of my suspects...The information was useful...you pursue that information. Maybe it will help your investigation..."[1143]

[1142] *Author Interview with former DSO investigator, September 2009*
[1143] *Ibid.*

Maybe it will more often not help, as one Deputy Director of Public Prosecutions[1144] told me.

> **Author**: Are there any cases that have been finalised by your unit that emanated from the Financial Intelligence Centre referrals?
>
> **DDPP**: No Sir, No Sir, none that I know of. No.
>
> **Author**: As a manager of this place...?
>
> **DDPP**: Maybe, let's take a classical example. The FIC receives a suspicious transaction report. They refer it to the police. They investigate and they see, oh, this guy is a fraudster, put a docket together and bring it to us, we prosecute it and convict a guy. No one (case) has happened where I can go back to the FIC and say "thank you for your suspicious transaction report, based on that we got this."

Conclusion and Recommendations

Above we have discussed the FTRs regime in South Africa examining its outcomes. It appears from the evidence presented that the regime has so far made an unsatisfactory progress towards its alleged goals of detecting crime. This is despite perceptions of high levels of crime and corruption in the country, which such a system should be exposing. FTRs could potentially provide valuable information in this regard. It appears however that the FTRs are not yet contributing consistently to these publicly interested outcomes of detecting crime, despite efforts and resources expended on the regime. They clearly do not, however, appear to be playing a meaningful role. As also shown above in the cases of the US and the UK, South Africa's situation is not so peculiar.

[1144] A Deputy Director of Public Prosecutions is a senior position within the National Prosecuting Authority. The interviewee held a position where he was aware of all the prosecutions conducted in his division and how they emanated to their disposition as the Head of a Unit within the NPA.

Several reviews have been conducted in these countries and they have been struggling to make their regimes more effective and efficient.

In conclusion, it is important to make some recommendations for South Africa's FTRs regime. We make these recommendations despite our findings that the regime might not have been incorporated for crime detection purposes, but for other narrow interests. Perhaps the regime could still be rescued as South Africa appears not to have much choice but to continue implementing it. We say this because, as we show in Chapter 8, the global AML regime has been merged with the IMF and World Bank Financial Sector Assessment Programmes which determine a country's credit rating and thus affecting its ability to issue debt at reasonable costs. Since these measures would be implemented, there might therefore be a need to fine-tune those that work since South Africa also faces, according to this study's participants, a formidable problem of organised crime and corruption. Advocate Willie Hofmeyr retorted during our interview that his experience has been that

> "A lot of the regulations around anti-money laundering measures have sought of got caught up in this sort of Cold War debates about developing and imperialist countries in the colonial world and all of that. Some aspects of it are true, but I mean it is sort of a debate that we have to get beyond and see what is the real value of using the anti-money laundering tools to combat organised crime, but quite importantly also, corruption."[1145]

These are very instructive and challenging words. They urge South Africa, and developing countries in general, to try those systems that work while also trying to see what the problems may be with those systems that do not yet assist. They also do encourage developing countries to start to own up and take responsibility. He explained this in the context of South Africa's position in

[1145] *Author Interview with Adv. Willie Hofmeyr, October 2009*.

Africa, as a financial centre, and the world, as an investing destination, when it comes to organised crime. He said that the fact that South Africa is a

> "…sort of a financial centre in Africa means that we are both a country in which proceeds may be exported and invested in Europe and so on, but we are also actually an investing country. A lot of African dirty money comes to South Africa. Cape Town especially has become a little bit of a Monaco-type destination. So you find a lot of high profile European white-collar-criminals or drug people investing in the Western Cape wine farms or golf estates or Clifton bungalows. We are also not in the traditional developing country place where you are only making requests to other countries to please send back the money that has been stolen here and exported. But we get a lot of incoming requests for asset forfeiture from other countries, both developing and developed. Actually we probably get more requests from Europe to help them with people who have hidden their money here than we make requests to Europe."

All participants in this study did express some concerns about organised crime and corruption. The schemes which were mentioned as prevalent within the private sector, especially in the banking industry, were issues of credit card fraud, particularly in relation to card skimming and counterfeiting. Susan Coetzee of SABRIC told us that

> "Even now with the recession, with the economic downturn, there is an average of 25 million Rands per month that is being lost on credit card fraud. Last year there were months where it went up to 40 million Rands a month… If you take credit card crime in this country, at the moment there has been a huge decline in actual successful frauds. We do not have any figures with regards to what the attempted frauds are because our system does not cater for that. The reason why there has been a decline in the frauds, in actual losses, is not necessarily because there has been a decline in the attempted frauds. It's because people's credit cards are maxed.

So if you try and do fraud with it [a counterfeit card], it would not go through because there is no money in it and that for me it is why it's down and because of the roll-out of chip-and-pin. But if you look in last year, at the peak, there were 80,000 incidents of credit card fraud in any one month. Now if you thought it was opportunistic crime, you should be changing your mind now."[1146]

Compliance officers from the South African banks that we spoke to did emphasise card skimming and counterfeiting as a major crime issue within the banking sector[1147]. While the figures that SABRIC had only related to credit card fraud, there were issues about debit card fraud as well, whose statistics were not centralised by then.

"The size of debit card fraud is unknown because of the fact that the information is not centralised within all of the banks. Definitely all attempts are being made to get the information into SABRIC now…So if I am telling you that at the peak last year there were 80,000 incidents of credit card fraud and that for every one credit card, there are 17 debit cards, you can do your own deductions with regards to what the potential of debit card fraud is in this country."[1148]

On the issue affecting the public sector, most participants from within the criminal justice system decried the scourge of fraud and corruption against or within government. I asked a Deputy Director of Public Prosecutions attached to the Asset Forfeiture Unit about the nature of organised crime, generally.

Author: What would you say are the main organised crime activities in South Africa right now?

Participant: Drugs and corruption

[1146] *Author Interview with Susan Coetzee of SABRIC, October 2009*

[1147] One of the Compliance Officers of a South African bank told as "the largest crimes going on in South Africa at the moment and it's kind of the world trend is card-skimming—where people make counterfeit cards"

[1148] *Author Interview with Susan Coetzee of SABRIC, October 2009*

> **Author**: Government corruption or just corruption everywhere.
>
> **Participant**: Government. Of course, we have others like human trafficking and so on, but the main ones are drugs and government corruption.
>
> **Author**: Are you having a lot of cases on government corruption?
>
> **Participant**: Ja, there is quite a lot.
>
> **Author**: Finalised cases as well?
>
> **Participant**: We have a few finalised cases involving government corruption. We are currently busy with a lot of them…Right now, South Africa is doing a lot of activities in reconstruction and development, you know. A lot of infrastructure is being built, you know, tenders are out. So in that area, among others, private individuals and government officials develop close working relationships and interests, you know, where big value tenders are awarded…
>
> **Author**: How big are the sums involved in some of these government corruption cases?
>
> **Participant**: The R219 million case I am doing currently involves fraud and corruption. It relates to a tender that was awarded. So that is a case in point that I am telling you about. The R88 million case that we did last year was again linked to government fraud and corruption[1149].

All these issues of organised crime and corruption call for a concerted drive to fix South Africa's mechanisms to fight organised crime and corruption. It would therefore be very important to deal with issues around the FTRs as they have shown to be less beneficial to the fight against crime in South Africa. Many of my interviewees who deal with the FIC were of the view that there is still room for improvement in South Africa's FTRs regime, generally. By this improvement they meant, among other things, that the regime should start to provide information that could be used to detect and solve crime. To this end we offer the following recommendations.

[1149] *Author interview with a Deputy Director of Public Prosecutions, September 2009*

The South African government should consider an independent review of its regime in order to find out where the problems might be with the low success rate of FTRs. South Africa's reviews have only been done by the FATF through its Mutual Evaluation Programme. While the FICA regime was itself imposed by the FATF, South Africa needs to start assuming full ownership of the regime.

There needs to be a shift of mindset from pleasing the FATF, IMF and World Bank (who have made the adoption of AML/CTF measures part of the conditions attaching to extending loans and assistance to developing countries (see discussion on this in Chapter 8 below)), into making the regime work for South Africans. It is ordinary South Africans who foot the bill for this expensive regime. At a local level, the costs of running the regime are borne by local businesses and the government. Both business and government have the luxury of passing down these costs to ordinary South Africans in a number of ways, especially via their pricing schemes of businesses and taxes, respectively. At the end of the day, the effectiveness and efficiency of the reporting regime should be in their interest and thus help to solve and reduce crime. The South African government has, of course, showed some tremendous commitment to meeting these so called international best practice standards through its laws and implementation efforts.

The independent review that we are proposing should investigate the effectiveness and efficiency of the reporting regime in South Africa since 2003, when the FIC was formed. This would entail enquiring into the costs of the regime, from compliance to enforcement. It should also entail an inquiry into the benefits of the regime, including the extent to which the FIC's intelligence has helped to detect crime internally and in other jurisdictions with which the FIC shares its intelligence. This review should enjoy the support of government to enable independent reviewers to access adequate resources and information to carry out such a task. It would also provide a more in-depth view to the one presented by the FIC in its annual reports and the FATF in its mutual evaluations.

The FIC cannot be expected objectively to review itself, for obvious reasons. Its employees and managers may have a vested interest and incentive in portraying a cost-efficient and effective regime and thus lack objectivity. On the other hand, although the FATF has, in a way, contributed to the understanding of South Africa's regime, its mutual evaluations seek to assess everything (all the components of its 40+9 Recommendations) in a rather schematic way; shedding little light on the effectiveness and efficiency of the FTRs regime[1150]. The FATF may have a bias towards legitimating, defending and extending the regime, whether it works or not -- as it has always done through NCCT naming and shaming blacklists. Independent reviewers would ideally be unencumbered by such biases, and therefore be able to propose drastic measures or changes with a view of improving matters, where feasible, for South Africa and its people.

There are other issues that still need to be clarified about the FIC itself. These are broader issues of accountability, its role (whether it is an intelligence organisation or investigative body or just a repository of information) and functions. If the FIC is an intelligence organisation, parliament may need to consider whether it should fall under some oversight like other intelligence oriented organisations in the country or not. If not, clear justifications may need to be advanced, especially since the FIC shares this intelligence across borders with limited or no judicial oversight of its activities. The problem with lack of oversight is that it poses a risk of FIC intelligence being used for reasons other than those of detecting crime. Although there is no evidence that this has happened, financial intelligence in the wrong hands could be used selectively. It could be used as a fishing expedition in targeting political rivalries and in gathering intelligence for purposes of 'regime change' as this information is shared with foreign FIUs without any binding requirements for such information sharing to happen via the courts as happens with subpoenas in criminal investigations.

Fixing accountability mechanisms of the FIC proactively would help to prevent apprehensions similar to those that attended the now disbanded DSO (Scorpions) when human

[1150] The Mutual Evaluation Reports of the FATF do provide some useful information but do not go far enough.

rights violation incidents were alleged to have occurred there -- giving ammunition to those who campaigned successfully for its disbandment. If such incidents ever happen while the FIC tries to fulfil its mandate, there should be proper safeguards in place. Feedback should also be given to regulated institutions to enable them to improve their transaction monitoring and reporting systems.

Chapter 8

Claiming and contesting legitimacy:

Merging FATF standards with IMF and World Bank 'conditionalities'

Introduction

An increasing amount of evidence regarding the global FATF standards points, as mentioned earlier, to efforts that have not yet achieved their alleged objectives and purposes of detecting and combating crime. Nor have they been satisfactorily shown to preserve the integrity and soundness of the financial system from abuse by criminals. Fairly recently major banks in the US, the UK and other industrialised jurisdictions nearly collapsed, needing enormous amounts of taxpayers' money in bailouts. This appears to challenge the neoliberal orthodoxy of self-correcting markets. The interesting thing about the entire calamity of the so-called global financial crisis is that it did not originate from the largely imagined external sources of systemic risk such as drug-trafficking money launderers, terrorists and others that much of the global financial regulatory regime has targeted in the recent decades. Its sources appear to have been internal and to have originated from the market players whose greed and excesses at profit-making were often encouraged by neoliberal capitalism[1151].

The past couple of decades have seen more regulation directed at combating money laundering and terrorist financing than to the badly needed prudential regulation, which has been found to be lacking in the midst of this recent crisis[1152]. The lack of focus on the latter has brought the global financial system to the brink. Instead of more efforts on prudential regulation, more energy has been focused on the FATF standards. In developing countries, the FATF standards, as

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[1151] See Morgan, G. 2010. Legitimacy in financial markets: credit default swaps in the current crisis. *Socio-Economic Review*. Vol. 8, pp.17-45, who has meticulously analysed the rapid expansion of credit default swaps market and lack of prudential regulation which, he argues, led to the collapse of this market.
[1152] *ibid*.

has been established, were imposed through coercion, and have become part of the neoliberal structural adjustments of the IMF and the World Bank -- which these countries must now implement or risk having their funding and credit lines compromised.

Despite concerns about the ineffectiveness and inefficiency of the FATF standards of financial regulation, many countries continue to forge ahead with their implementation. The FATF also carries on conducting peer reviews (mutual evaluation) on both its members and non-members through the so-called "FATF-Style Regional Bodies" (or FSRBs) that have mushroomed over the past two decades. The compliance industry has seized on the benefits brought by the FATF standards with civil servants, auditing, accountancy, information technology, security and law firms cashing in on such services as forensic investigations, compliance management, automated transaction monitoring systems, training, and market research. There are a number of explanations and justifications that have been advanced to try and rationalise the limitations of the regime in achieving its goals. Key among them has been that the regime is new, thus too early to be judged or expected to produce any meaningful outcomes. This is despite the four decades of its implementation in the US and more than two decades in other major developed countries. In developing countries the FATF standards were incrementally introduced in the 1990s, but earnestly started to be implemented after the FATF's NCCTs blacklisting campaign. The drive to incorporate the FATF standards, it appears, has been further propelled by their merging with the global anti-terror initiatives after the 9/11 terrorist bombings in the US.

In this work we have probed competing explanations and justifications for the global emergence and domestic incorporation of the FATF standards in developing countries, based on the public and private interest theories of regulation. The powerful discourse of transnational crime and the management of systemic risk were propounded by the FATF (and its principals) in order to legitimate or justify the need and existence of the regime. Since the regime has already been incorporated by many countries, even under pressure from those who promoted it, the custodians of this regime within those developing countries may not be faulted in thinking and believing that the regime initially emerged to serve publicly-interested goals. Nor may they be faulted for believing that since the regime was incorporated to serve these publicly interested goals of detecting crime, it might soon start delivering its expected or promised outcomes. Were the regime to begin to show positive signs in the detection of crime, it could then be said that its enactment serves the public interest as it may help to solve some pressing social problems of crime. This could provide the regime with some 'output legitimacy'. It would even justify the expenditures from all sectors of society in implementing and complying with it if it yielded benefits that, at least, balance, or perhaps even outweigh, the costs.

However, as we have seen above, the regime appears not to have done this in South Africa. The situation is broadly the same in countries that we have drawn some comparisons from in assessing the outcomes of FTRs in Chapter 7. We have also seen the challenges the regime presents and the grave implications it potentially has when implemented under developing country socio-economic conditions. These challenges relate to issues of socio-economic exclusion which have serious consequences for socio-economic development. Greater socio-economic exclusion could further undermine social cohesion, especially in a society such as South Africa that is seeking to heal a variety of social ills that were brought about by apartheid. Further, excluding large sectors of society from using formal financial services could militate against the very alleged objectives of the regime of monitoring the abuse of the financial system and of detecting crime. All these problems tend to challenge the implementation of the regime in developing countries. Counting against the regime as well is that it was imposed from outside. Most importantly, the regime itself does not yet help to detect crime even as it potentially alienates the poor. How then does South Africa justify its further implementation of these financial regulations? What legitimacy claims does this regime have? Was it legitimate for South Africa to adopt it? Is the global FATF regime legitimate?

In this chapter, we explain the claimed legitimacy of the FATF regime and suggest limitations. We offer an explanation as to why South Africa, like other developing countries, will continue to implement these globally imposed standards despite their lack of legitimacy, along with the absence of any encouraging and substantial evidence of their effectiveness and efficiency. The global FATF regime lacked legitimacy when it was adopted by South Africa and other developing countries that were not its members when the regime was conceived. We argue that because of its lack of legitimacy at a global level, the regime's adoption in South Africa lacked legitimacy. The main reason for its lack of legitimacy, we claim, is that the regime was, first and foremost, not extended by its founders for the alleged publicly interested goals of detecting crime. Crime was merely incidental. Other reasons for lack of legitimacy concern issues of democracy and the coercive manner in which the regime was extended to developing countries. We argue, however, that despite the regime's inefficiencies and ineffectiveness, it will continue to be implemented. This is because the FATF standards have been merged with the neoliberal structural adjustments of the IMF and the World Bank and compliance with them has become one major criterion by the private sector agencies that develop credit ratings for countries.

Imagining legitimacy for non-state transnational regulatory regimes

Here we start by examining the concept of legitimacy within the context of transnational non-state (or non-legally mandated[1153]) regulators, which the FATF is. There are many other organisations operating at a transnational level in various areas and with different levels of state involvement. These include such organisations as the Basel Committee on Banking Supervision (BCBS), which plays a major role in setting banking regulatory and supervisory standards; International Organisation of Securities Commissions (IOSCO), which sets standards for the regulation of securities and stock exchanges; and the Financial Stability Board, which was recently set up by the G20 to devise strategies for what has been referred to as the global economic recovery

[1153] I have borrowed from Julia Black's use of 'state' and 'non-state' to respectively refer to regulatory regimes which are mandated by either local, national or supranational law and those that are not. See Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168.

since the start of the global financial crisis which began in late 2007. There are many more similar non-state bodies that play a governance role. Julia Black has meticulously described the environment under which these non-state organisations operate. She tells us that non-state transnational regulators share a characteristic in that their activities ‘are not based on or mandated by national, supranational or international law’[1154]. While they are founded by nation-states, they have no statutory bases and claim their legitimacy, if at all, from the states that establish them. Other characteristics[1155] of such non-state regulators are that there are no existing structures such as courts, legislative committees, national auditors, ombudsmen and so on through which recourse and accountability can be sought. They have no clear jurisdictional boundaries nor there any easily identifiable set of potential democratic participants in their processes[1156]. Another important characteristic is that states play a role in many of these non-state organisations as members, principals and regulatees/subjects. In other words, these are soft law regimes. Alexander, *et al.*, have explained that soft law “generally presumes consent to basic standards and norms of state practice, but without the *opinion juris* necessary to form binding obligations under customary international law.”[1157] Soft law, therefore, exists outside the traditional legal arena of treaty or uniform customary state practice[1158].

Organisations operating without a legally binding mandate are referred to throughout this chapter as non-state actors/organisations. This may seem contradictory and confusing since the FATF and other similar organisations are formed and dominated by states. However, non-state is used to denote their non-convention, non-treaty and therefore non-legal mandate. The legitimacy of non-state organisations, and their activities, can be questioned on the basis of their non-legal

[1154] *Ibid.*
[1155] *Ibid.*
[1156] *Ibid.*
[1157] Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York: Oxford University Press. p. 138.
[1158] *Ibid.*

status[1159]. There is also a widespread tendency to exclusivity of membership that is biased against developing countries in these non-state organisations. This leads to charges of non-representativeness and lack of 'input legitimacy' on some of these organisations and their regulatory standards[1160]. But, what is this legitimacy that is claimed and contested and why is it important?

Defining legitimacy

Mark Suchman observed that legitimacy tends to be more invoked than described and more often described than defined[1161]. The etymology of the word suggests it to be a concept rooted in law. For instance, according to the Concise Oxford English Dictionary, legitimacy is "the state of being legitimate or valid" and being legitimate means "conforming to the law or to rules" [1162]. However, this may be too similar to legality. Another conception is of "being able to be defended with logic or justification" [1163]. However legitimacy is used in various contexts other than legal. The latter meaning of 'being able to be defended with logic and justification' means the concept of legitimacy can be used to defend non-legal rules and even illegal action, when such is done with 'logic and justification'. For instance, South Africa's apartheid statutory laws were legally valid and judges applied them, although many others who opposed the system of apartheid regarded them as illegitimate. They disrespected them because they perceived them to violate some basic values and norms, such as freedom, democracy, non-discrimination, and justice.

Writing on organisational management theory, Suchman defines legitimacy within a sociological context to mean "a generalised perception or assumption that the actions of an entity

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[1159] *Ibid. See also* Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168.
[1160] *Ibid.*
[1161] Suchman, M.C. 1995. Managing legitimacy: strategic and institutional approaches. *Academy of Management Review*. Vol. 20, No. 3, pp. 571-610,
[1162] *Concise Oxford English Dictionary*. 2006. Oxford University Press, 11th Edition, p.814.
[1163] *Ibid.*

are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, or definitions."[1164] In a governance or regulatory context, Black says a regulator is legitimate when s/he is "perceived as having a right to govern by both those [s/he] seeks to govern and those on behalf of whom [s/he] purports to govern"[1165]. In this exercise, as we examine the FATF, we use the latter definition, which seems to blend in with a broader concept of regulation. This conception of legitimacy accommodates the regulatory context where both legal and non-legal authority is exercised.

Legitimacy, according to Julia Black, is rooted in the acceptance of an organisation by others, and 'more particularly in the reasons for that acceptance'[1166]. There could be various reasons, beyond the legal ones, for the acceptability and credibility of a regime. These reasons could be 'pragmatically-based', 'morally-based' or 'cognitively-based'[1167]. Pragmatically-based reasons involve perceptions on the part of subjects that the regulator 'would pursue their interests directly or indirectly'[1168]. Morally-based reasons are based on perceptions of regulatees that the goals and/or procedures of the regulator are morally appropriate[1169]. Cognitively-based reasons refer to the acceptance of an organisation as necessary or inevitable, based on its knowledge or expertise and capability to provide solutions to the problems identified or achieving the end or ends desired[1170]. The reasons may still be legally-based ones for legitimation. Max Weber argued that law can be a basis of legitimation of authority, but also charisma and tradition[1171]. It is

[1164] Suchman, M.C. 1995. Managing legitimacy: strategic and institutional approaches. *Academy of Management Review*. Vol. 20, No. 3, pp. 571-610,
[1165] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168.
[1166] *Ibid.* p. 144.
[1167] *Ibid.*
[1168] *Ibid.*
[1169] For instance, the FATF seeks to deal with problems of crime and safeguard the financial system from criminal abuse. These would seem to be noble and desirable goals for many, if not all, democratic states, whether developing or developed; members of the FATF or not. Many countries beyond the FATF membership would support the goals which the FATF standards claim to represent, such as combating crime and protecting the financial system.
[1170] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168.
[1171] Vogel, M.E. 2008. Situating Legislative Drafting. *European Journal of Law Reform,* Vol. 10, No. 2, pp. 275-293.

important to say a word on these two later forms of legitimation as traditional legitimation applies in the case of the FATF. On charisma, Weber argued that a people or community may obey authority based on the charisma of a leader[1172]. Traditional legitimation relies on respect for age-old traditions and customs where a community obeys orders of elders and children, their parents. Julia Black has correctly observed that using law or legal validity to assess the legitimacy of transnational non-state regimes, such as the one of the FATF, would be futile as they would out-rightly be found to be illegitimate[1173]. This is simply because these regimes are non-legally mandated. As she puts it,

> "When regulatory regimes are largely non-legal and where, as in transnational regimes, infusing them with law is problematic, using only a legal concept of legitimacy will lead us to a dead end: such regimes will necessarily lack legitimacy and any potential for legitimacy, in legal terms. They may, however, still be regarded as perfectly legitimate by others."[1174]

In assessing the legitimacy claims of the FATF, we follow this advice from Black; otherwise we would have to conclude our analysis and brand the FATF regime, which is not founded on binding law, as out-rightly illegitimate. We start from a premise, then, that non-legally based regimes may still enjoy other forms of legitimation and be socially and politically acceptable. In assessing such non-state regimes therefore, we may find that their legitimacy fluctuates with the fulfilment (or otherwise) of various acceptable justifications/reasons. Put differently, the reasons which form the basis of legitimacy assessments affect either positively or negatively the thresholds or levels of legitimacy in a regime. This means that some subjects may perceive a regime to be legitimate based on different sets of values, norms and beliefs, reasons and

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[1172] *Ibid.*
Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168.
[1174] *Ibid.* p.145.

interests than others[1175]. Norms, values, reasons, interests and beliefs may not be widely/equally shared, thus making the regime perfectly legitimate for some and less so or completely illegitimate for others[1176].

Significance of legitimacy

The question of legitimacy is key to any attempt at behavioural change at any level of governance, but more so at a transnational non-state level where systems are not as developed as within liberal-democratic nation-states[1177]. At a global level, the systems are at their formative stage, having been developed to fill the governance gap left by the recently increased economic neo-liberalisation and the globalisation of markets[1178]. An interesting reality at this level is that there is presently no sovereign world government. This absence of sovereign authority has led to various forms of governance arrangements. It is argued that transnational non-state regimes strongly need legitimacy as 'they have to promote a strong motivational response from those whose behaviour...they seek to change, but often without the legal infrastructure of legal authority to fall back on'[1179].

It is widely believed that the governed tend to voluntarily comply with authority they believe to be legitimate. Legitimacy may therefore motivate not just voluntary compliance, but commitment and ownership. Voluntary compliance is important as it is generally believed to be

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[1175] *Ibid.* p.145, See also Suchman, M.C. 1995. Managing legitimacy: strategic and institutional approaches. *Academy of Management Review*. Vol. 20, No. 3, pp. 571-610.
[1176] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance.* Vol. 1, No. 1, p.145.
[1177] Quack, S. 2010. Law, expertise and legitimacy in transnational economic governance: an introduction, *Socio-Economic Review*, Vol. 8, 3-16.
[1178] *Ibid.*
[1179] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance*, Vol. 1, No. 1, pp. 137-168.

more cost efficient than coercion[1180]. Coercion is believed to necessitate greater costs of enforcement which could be avoided when compliance is voluntary[1181]. However this view of cost-efficiency of voluntary compliance might be dependent on cases under consideration as coercion may be a cheaper and easier option for regulators to disseminate regimes that tend to be unpopular or illegitimate. Seeking consent may lead to protracted deliberations which may end up in deadlocks and thus compromise the speed at which such regimes can be diffused to their intended recipients.

Rainer Hülsse has explained quite convincingly how voluntary compliance may facilitate and encourage 'actual compliance' as opposed to 'formal compliance'[1182]. Formal compliance could be likened to 'window-dressing'; something that is fashioned to deceivingly appease. Actual compliance, on the other hand, carries connotations of a real belief in something, which may in turn facilitate ownership of norms, values and rules and commitment to their implementation and enforcement. Transnational regimes, more so non-state, are thought to require 'actual compliance' as their regulatory standards depend on their regulatees/subjects for implementation and enforcement. Transnational regulators could therefore be regarded as primary regulators because they regulate states which are then expected to do the same with their constituencies for the regimes to be effective. As a result of this reliance on their subjects, these regulators do not just need 'passive', but 'active' support from their subjects[1183]. If their subjects do not believe in their legitimacy, their goals and programmes may end up getting lip-service, if adopted at all.

This may compromise the potential effectiveness of such regimes, as national governments resource-starve implementation and enforcement efforts. Rainer Hülsse believes that effectiveness of 'club' (non-state) regimes cannot be achieved without winning actual compliance which, in

[1180] Hülsse, R. 2009. Even clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended. *Regulation and Governance*, Vol. 2, 459-479.
[1181] *Ibid.*
[1182] *Ibid.*
[1183] Suchman, M.C. 1995. Managing legitimacy: strategic and institutional approaches. *Academy of Management Review*, Vol. 20, No. 3, pp. 571-610.

turn, is better achieved through voluntary compliance than force[1184]. According to him, while formal compliance can be achieved through coercion, actual compliance cannot be guaranteed[1185]. The question of legitimacy is therefore very important in this context of multilevel regulatory regimes characterised by interdependence of regulatory functions and roles. Even at national level, national governments may strongly need and rely on the legitimacy of transnational regulators to motivate voluntary compliance from their subjects (local constituencies)[1186]. While governments often establish laws and regulations, which back and legitimate their governance efforts, they may also need to convince their local constituencies that the agreements they enter into, on their behalf, are accountable and in their best interests. This may especially be true when such standards could have a negative impact on these constituencies. We are not arguing that all agreements entered into by countries should always represent a win-win situation. International agreements often do entail compromises, especially in an interdependent world coloured by a variety of interests, values, norms and reciprocity.

The obligations or agreements that national governments observe at a transnational level, whether based on soft or hard law, have a long chain of accountability. This chain tends to get weaker and weaker the furthest it is from the source of original delegation[1187]. Transnational governance in many liberal democracies is delegated authority, which is usually given to the executive arm of government (i.e. cabinet ministries), which, very often, further delegate to the concerned departments or non-departmental regulatory bodies. Normatively, those mandated to exercise this authority on behalf of the state within democratic states should not, although this often happens in small and developing countries, overstep the trust put on them by their electorate by entering into often compromising agreements.

[1184] Hülsse, R. 2009. Even clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended. *Regulation and Governance,* Vol. 2, 459-479.
[1185] *Ibid.*
[1186] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168.
[1187] *Ibid.*

This is simply because it is the local constituencies that bear the costs of such commitments either through the public purse or through costs passed on to them in other ways, i.e. businesses passing down compliance costs, directly or indirectly, to consumers. In the worst scenario, such obligations may have negative implications for social development and economic growth. There might therefore be a need to account for, justify and defend the adoption of such informal standards, which are not part of international law obligations, in which governments enter into. Entering into forced arrangements may therefore be untenable and be correctly viewed as illegitimate.

There has been an increasing amount of literature that analyses issues of legitimacy above and beyond the state. Some of this literature is normative and some empirical[1188]. Normative means literature that is inclined towards ideals or things as they ought to be, as opposed to reality or things as they actually are; which empirical literature contributes to. These strands of literature often intersect. For instance normative enquiries may rely on empirical literature to make more informed suggestions on how things should be[1189]. We attempt to contribute to both these approaches in the area of the global AML regime and developing countries, in general, and South Africa in particular.

Our intention is to show how the FATF tried and failed to build its legitimacy from its early years and totally lost it when it started to apply coercive measures of blacklisting non-members to adopt and implement what was supposed and proclaimed to be voluntary and flexible standards. We also argue that the FATF did not just fail to legitimate itself and its standards, but it might have done so deliberately. On the other hand it might not have failed deliberately, but did not need legitimacy in respect of its non-members, but force, as the regime was not formed for the purposes that needed legitimation. By this we means that the standards were inherently illegitimate to the

[1188] Quack, S. 2010. Law, expertise and legitimacy in transnational economic governance: an introduction, *Socio-Economic Review*, Vol. 8, 3-16.

[1189] Julia Black states this succinctly when she says empirical questions are important in their own right and "they are also the logically prior questions that have to be asked before any 'how to' proposals can be made" Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance*, Vol. 1, No. 1, p.138-139.

extent that they could not be rescued by any means except coercion as the FATF was not primarily formed to deal with crime, but to use public sentiment about crime in order to 'govern' competition (regulatory and tax arbitrage) issues[1190].

Julia Black has correctly observed that new organisations often have a mammoth task of actively constructing their legitimacy from scratch and, old ones, maintaining it[1191]. When their legitimacy gets challenged, they may and often do actively engage in activities to reclaim or repair it[1192]. Our argument here is that the FATF failed to build its legitimacy from the start, with regards to its non-members. It may have been regarded as legitimate by its members (as its principals) but it clearly was not to its non-members, who were treated as mere rule-takers[1193]. The legitimacy question here is with regards to its non-members since 1992 until the regime was effectively disseminated throughout the world by the early 2000s.

Although a few of these countries were later slowly and carefully recruited for membership in the FATF, which now brings its total membership to 36 countries, from 28 in 1992, these countries nonetheless appear to have been forced to incorporate the regime, as shown in the case of South Africa in *Chapter 5* and as argued by others[1194]. It is however important to distinguish between the legitimacy of the FATF as an organisation and the legitimacy of its standards. While non-members might not accept the FATF because it has been inherently undemocratic, they might

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[1190] I borrow this concept of 'governing through crime' from Jonathan Simon's incisive work on how crime is often used to govern other political issues in his work Governing Through Crime. See Simons, J. 2007 *Governing through crime: how the war on crime transformed American democracy and created a culture of fear*. Oxford: Oxford University Press.

[1191] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp.138-139.

[1192] Suchman, M.C. 1995. Managing legitimacy: strategic and institutional approaches. *Academy of Management Review,* Vol. 20, No. 3, pp. 571-610, p. 588.

[1193] This would depend on the perceptions of each and every non-member affected by the FATF regime, as perceptions about the FATF's legitimacy may not be the same for each and every subject.

[1194] See Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), pp. 635-656, Hülsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society.* Vol., 21(2), pp. 155-178, Hülsse, R. 2009. Even clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended. *Regulation and Governance,* Vol. 2, 459-479 and Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy.* Vol. 12(5), 841-859.

still support its standards if they are morally, pragmatically or cognitively justifiable. The support for standards does not necessarily make the FATF democratic or legitimate.

FATF strategies: building or destroying legitimacy?

When considering issues of legitimation and the FATF, it is important first to analyse the nature[1195] of this dynamic body and what it sought and seeks to achieve[1196]. It is the FATF's nature, goals and activities that have, over the years, enhanced its legitimation crisis. From the start, instead of building its legitimacy, it seems to have worked against itself. To start with, we view the FATF primarily as a transnational non-state 'regulatory body'[1197] that claimed and largely grew to be viewed as the primary custodian of the global AML (and later AML/CTF) standards[1198]. Secondly, its primary activity, in short, has been to regulate countries and territories[1199] to adopt, implement and comply with its standards. It is important to decode these two broad statements.

We start this by reminding ourselves on what is meant by 'regulation'. This is central to what the FATF is and does as a global/transnational regulator. In its website and reports, the FATF incompletely describes itself as a 'policy-making body'[1200]. Although it does loosely mention its other activities, there is a more encompassing description for its nature and broad range of

[1195] By its nature, it is meant the kind of a body the FATF is.
[1196] By what it seeks to achieve is meant its goals and its programmes and activities that are geared towards achieving these goals.
[1197] This is different to what the FATF describes itself as. It describes itself as follows; "The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The Task Force is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas." Retrieved from: http://www.fatfgafi.org/document/57/0,3746,en_32250379_32235720_34432121_1_1_1_1,00.html.
[1198] We say it 'claimed' because we have argued that the actual goals of the FATF as an organization differ from its official goals as our private interest hypothesis of regulation has shown (See Chapter 5).
[1199] Territories are those jurisdictions that are dependencies of other countries, such as Crown Dependencies of Britain, the UK and so on.
[1200] Retrieved from: http://www.fatfgafi.org/document/57/0,3746,en_32250379_32235720_34432121_1_1_1_1,00.html

activities. We view the FATF as a non-state regulatory body. In defining regulation, we return to Julia Black's broad definition we saw earlier which defines regulation as

> "…sustained and focused attempts to change the behaviour of others in order to address a collective problem or attain an identified end or ends, usually through a combination of rules or norms and some means for their implementation and enforcement which can be legal or non-legal."[1201]

The FATF sought to change the behaviour of its subjects, which are governments, to attain compliance with its standards. It initially did this through encouraging and monitoring its subject's implementation of standards, through its programmes of mutual evaluation[1202]. These mutual evaluations also helped it to enforce compliance by identifying changes or reforms that needed to be undertaken by those it found to be non-compliant. Embedded in its standards were also sanctioning mechanisms that it could apply to members who failed to comply, such as suspension of membership[1203]. However this labelling, naming and shaming mechanism has never been used against members, but threatened against Turkey in 1996 and Austria in 2000[1204].

With all these regulatory enforcement mechanisms, the FATF is a full regulatory body and even more given that it also sets the standards (policy-making) that it monitors and enforces. Also, although without any legal backing, its sanctioning mechanisms have made it achieve a high level of compliance among non-members, which had no legal obligation at all to follow or support it. On its standards, it is important to acknowledge that while a portion of the FATF standards were borrowed from binding international law, particularly the UN Vienna Convention of 1988, its main contribution were standards which do not emanate from any international hard law convention or

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[1201] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance,* Vol. 1, No. 1, pp. 137-168, p.138.
[1202] See Chapter 2 above for more details on the FATF's mutual evaluation programme.
[1203] Regulation 21 of the FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris: FATF Secretariat, OECD..
[1204] FATF. 1997. *Annual Report 1996-1997*. OECD, Paris, June 1997.

treaty[1205]. The contribution we are referring to here are its set of standards that recommended the regulation of financial and nonfinancial businesses for purposes of combating money laundering and the conceptualization of what has become known as financial intelligence units (FIUs).

The business regulations of the FATF have been transformed from being soft law norms into international and national binding law through their incorporation into subsequent UN conventions and protocols and other regional conventions of the Council of Europe and the EU Directives[1206]. They have also become part and parcel of many countries' legal and regulatory frameworks through voluntary and also coerced adoption. While the FATF standards are themselves soft law, they have therefore evolved into becoming binding international and national law[1207]. It is however important to mention that much of the elevation of these standards into international hard law occurred after they had been coercively disseminated by the FATF to many developing countries and made national laws. This is very important to highlight as it was the coercive transfer of soft law standards (then) which exacerbated the legitimacy crisis of the FATF regime[1208]. We have briefly analysed the FATF and its activities. Now we move to deal with issues of membership. This helps us to clarify whom the FATF seeks to govern (subjects) and on whose behalf (principals), as this affects its legitimacy and accountability.

FATF's principals and subjects

The FATF's subjects are those countries (and jurisdictions) that the FATF regulates, while on the other hand, its principals were those who formed it or were its members, in the context of

[1205] The FATF standards that emanate from UN hard law conventions are those that encouraged the criminalization of money laundering, cooperation (mutual legal assistance and extradition), and seizure of proceeds of crime. These were a product of the UN Vienna Convention against Illicit Drugs and Psychotropic Substances of 1988.
[1206] Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York: Oxford University Press.
[1207] See *Ibid.*
[1208] Hülsse, R. 2009. Even clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended. *Regulation and Governance*, Vol. 2, 459-479.

this analysis, when it closed accession to its membership in 1992. There is therefore an overlap in that its principals were also its subjects. There is also a disparity in that not all of its subjects were its principals, as it sought to regulate all countries even those that were not its members. The disparity in the FATF's subjects and principals has, we believe, enhanced its legitimation crisis. It is however not this disparity alone, but also the hidden interests in the emergence of the regime which added to its problems of legitimacy. We have already identified these interests that shadowed the emergence of the regime in Chapter 5, but it is important to reiterate them.

Private interests: regulatory and tax arbitrage

While the FATF standards were portrayed as efforts at combating crime, we have found them to be coloured by some specific narrow interests. As early as 1970, the US took a decision to regulate its banks through the Bank Secrecy Act of 1970. It desired other countries to do the same to prevent regulatory arbitrage as this would affect the competition of its banks with those of other unregulated jurisdictions[1209]. Secondly, there were sentiments among the G7 countries that the UN Vienna Convention was substantively inadequate and would take longer to be effective due to the delaying formalities of treaty ratification processes[1210]. The Vienna Convention was also viewed to be substantively inadequate[1211] in the sense that it did not come up with a financial regulatory regime of the sort that the FATF was to propose, an issue of great interest to the US which already had a financial regulatory regime while other developed and competitive countries

[1209] See Bosworth-Davies, R. 2007. Money laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp. 346-364.
[1210] FATF. 1990. *Annual Report 1990*, Paris: FATF Secretariat, OECD., p.11.
[1211] See Pieth, M. & Aiolf, G. 2003. Anti-money laundering: levelling the playing field, *Governance*, Basel Institution of Governance.

did not have[1212]. This was believed to have created regulatory arbitrage at the expense of the competitiveness of its financial institutions[1213].

Thirdly, France had proposed that the FATF should also deal with issues of tax (which basically involved cutting the competitive advantage of off-shore financial centres), which created issues of regulatory and tax arbitrage for on-shore financial centres[1214]. While France raised the issue of tax, other G7 countries, and their financial sectors may have stood to benefit from diminished off-shore financial centre competition in a number of ways. Regulation would decrease, if not eliminate, the competitive advantage of the so-called offshore regulatory havens, leading to repatriation of their business onshore, as there would be limited incentives to investing in offshore havens[1215].

While tax issues were not explicitly included in the FATF's mandate in 1989, as France and other (threatened) countries would have so desired, the standards changed in 1996 to directly incorporate issues of tax evasion, among many other serious crimes, as a predicate offence of money laundering[1216]. As early as 1991, the FATF had started to stigmatise these small countries as 'regulatory havens' who posed a serious risk of money laundering, laying a platform for further onslaughts on them[1217]. Issues of regulatory havens were to later become a programme of many

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[1212] See Bosworth-Davies, R. 2007. Money laundering: towards an alternative interpretation-chapter two. *Journal of Money Laundering Control*, pp. 346-364.
[1213] *Ibid.*
[1214] See Pieth, M. & Aiolf, G. 2003. Anti-money laundering: levelling the playing field, *Governance*, Basel Institution of Governance. See also Sharman, J.C. 2008. Power and discourse in policy diffusion: anti money laundering in developing countries, *International Studies Quarterly* (52), 635-656.
[1215] See for instance the language that the FATF uses in reference to offshore jurisdiction on FATF.1991. *Annual Report FATF 1990-1991*, Paris, 13 May 1991, p. 16. Retrieved from: http://www.fatf-gafi.org/dataoecd/20/18/33643115.pdf.
[1216] This happened as the FATF revised its 40 Recommendations to extend to all serious crimes beyond drug-related money laundering in 1996. This coincidentally happened under the Presidency of the US, which had for the first time chaired the FATF, and had from 1970s included tax evasion with business regulations on proceeds of crime (see Chapter 5 for more on this). FATF. 1996. *Annual Report 1995-1996*, Paris: FATF Secretariat.
[1217] Concerning 'regulatory havens' the FATF observed and concluded as follows; "In the process of geographical extension of the recommendations, it appeared clearly that some countries or territories could remain reluctant to join in the international effort against money laundering. The motivations for this reluctance are generally easy to understand. Some jurisdictions who wish to establish a financial services industry as a supplementary source of income for the national finances - through the sale of authorisation for shell companies and banking licenses - and to create

other FATF-linked organisations such as the OECD and other programmes of the IMF and the World Bank. This labelling led to some of these so-called regulatory havens to be blacklisted through the FATF NCCT programme[1218].

The FATF discourse on money laundering would appear to have been a smokescreen and a springboard to later tackle issues of tax arbitrage. While the regulatory havens were a more direct threat, developing countries in Africa and elsewhere were easily patronised. The AML standards, according to the FATF and others supporting it, would help them establish stronger financial institutions which would in turn assist them to develop as institutions (see discussion on this in *Chapter 2*). They would also assist them to monitor their corrupt leaders who siphon-out money to developed countries and offshore regulatory havens[1219]. Dictatorships and corruption are, of course, serious issues of concern in many parts of the world, particularly developing countries, but require more open and inclusive forums to reach decisions on how to tackle them rather than a patronising discourse aimed at spreading undemocratic regimes.

Extending the standards to non-principal subjects

The FATF was not keen to extend membership to all countries from the start. Its members were to be 'all OECD and financial centre countries'[1220]. "All other countries were invited to

employment for the population, use their lack of regulations as a competitive advantage. In addition, there are administrative costs in applying anti-money laundering sanctions. 'Regulatory havens' may therefore be motivated by a wish to supplement their budgetary receipts, gain a marketing advantage for their financial services industry, or avoid imposing a cost on their financial services industry, or any combination of all three. Finally, extreme cases, where governments co-operate with their financial institutions in large scale money laundering operations, cannot be excluded. These kinds of motivations to avoid taking measures against money laundering reflect clearly a short term view: a money laundering operation, once detected, can put at risk the whole financial system in these countries or territories, through the loss of credibility and confidence." See FATF (1991), Annual Report FATF 1990-1991, Paris, 13 May 1991, p. 16, http://www.fatf-gafi.org/dataoecd/20/18/33643115.pdf.

[1218] See below.

[1219] We have discussed this in Chapter 2.

[1220] See FATF.1991. *Annual Report FATF 1990-1991*, Paris, 13 May 1991, pp.1-5, http://www.fatf-gafi.org/dataoecd/20/18/33643115.pdf participate in the fight against money laundering and to implement the recommendations of the FATF"[1221] but were excluded from membership and any meaningful deliberative processes. The membership was therefore extended selectively based on a non-transparent criterion. In addition to its initial members[1222], Denmark, Finland, Greece, Ireland, New Zealand, Norway, Portugal, Turkey, Hong Kong and the Gulf Cooperation Council (collectively representing the Persian Gulf states of Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, and the United Arab Emirates) were invited for membership in 1991[1223].

In 1992, Singapore and Iceland were invited to become members, bringing the total membership to 28 (including the two regional organisations, the European Commission and the Gulf Cooperation Council). The FATF then concluded that its membership "should not be further widened, in order to preserve the efficiency of the Task Force"[1224]. Excluding countries whose compliance was sought would seem to have been a less than strategic move in trying to build and claim legitimacy. The FATF did not just need passive, but active support from non-members. This is simply because of the dependence of the FATF on these subjects to actively implement and enforce its standards at national level. What legitimation strategy, therefore, was the FATF using by closing membership and participation but yet seeking support from those it excluded?

Some financial centres or those countries it labelled as 'regulatory havens' and developing countries were not represented at all in this 28 member body when it decided to close its admission to new members in 1992. The main reason advanced by the FATF for its exclusivity was that it needed to preserve its 'efficiency'[1225]. Efficiency was therefore prioritised above democratic

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1221 *Ibid.*

1222 The initial membership consisted of 16 members comprising the G7 countries which are the US, UK, France, Italy, Canada, Japan, German and the EC (represented in the G7 by its President and therefore having one collective EC representative in the FATF) and non-G7 countries; Sweden, Netherlands, Luxemburg, Switzerland, Spain, Belgium, Austria and Australia. See FATF.1991. *Annual Report FATF 1990-1991*, Paris, 13 May 1991, pp.1-5, http://www.fatf-gafi.org/dataoecd/20/18/33643115.pdf

1223 See *Ibid.*

1224 *Ibid.*, p.19.

1225 See FATF.1992. *Annual Report FATF 1991-1992,* Paris, 25 June 1992, p. 18-21.

participation and representativeness in a drive to keep the costs of running the FATF 'low'[1226], and 'expediting' decision-making[1227]. Democratic representativeness and participation are normally associated with embracing dissenting viewpoints which may in turn lead to delays and deadlocks in decision making where there are disagreements. This fear or avoidance of dialogue and inclination to expeditious decision making, justified as grounds for ensuring or preserving the efficiency of the FATF, should be viewed sceptically and critically. We may ask therefore if the FATF, perhaps, suspected that its standards would not be so widely received or accepted and be opposed-- leading to delays in diffusing them to the countries it excluded.

It is important to ask this question, with the benefit of hindsight, given that the FATF standards are now considered to have had serious negative, but undeclared, economic impact particularly on developing countries and the so called regulatory havens[1228]. For some smaller countries stigmatised as regulatory havens, the implementation of FATF standards has led to, among other things, loss of business[1229], while causing unintended and undesirable consequences of financial exclusion in developing countries[1230]. Ironically, there is still no evidence that can be found to suggest that the regime is achieving its goals of detecting crime effectively and efficiently.

[1226] See FATF.1991. *Annual Report FATF 1990-1991*, Paris, 13 May 1991, p. 19.
[1227] In justifying the leanness of its membership, the FATF said it believed that a smaller informal organization made decision making easy and the organization, therefore, efficient and effective. See FATF.1992. *Annual Report FATF 1991-1992*, Paris, 25 June 1992, p. 18-21.
[1228] See Sharman, J.C. 2008. Power and discourse in policy diffusion: anti money laundering in developing countries, *International Studies Quarterly* (52), 635-656.
[1229] *Ibid.*
[1230] CGAP. 2005. *AML/CTF Regulation: implication for financial service providers*. Washington, DC (Jennifer Isern, David Porteous, Raul Hernandez-Coss and Chinyere Egwuagu) CGAP Focus Note No. 29. See also G:enesis.2008. *Implementing FATF standards in developing countries and financial inclusion: findings and guidelines.* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker), Final Report, February 2008, First Initiative.

Pragmatic, normative and cognitive legitimacy claims

What did the FATF rely on therefore in building and claiming its legitimacy during its early years, since it abandoned any effort to achieve democratic legitimation? We suggest that since it was unwilling to extend its membership and ensure participation and representativeness. or deliberative democracy, the FATF relied on strategies that rather corroded than affirmed its legitimacy. In doing this the FATF started by separating the organisation (or institutional hardware) from its standards (or institutional software)[1231]. It appears that the strategy was deliberately to delay legitimising the organisation (institutional hardware) but initially push for the worldwide diffusion of the standards (institutional software), using a combination of pragmatic, normative and cognitive legitimation claims. In its 1992 Annual Report the FATF, for instance, declared that it was

> "...the only body whose focus is exclusively on money laundering. Its substantive legitimacy stems from the political and moral obligation to implement the forty recommendations drawn up in 1990. On the one hand this implies a continuing emphasis in the FATF in verifying the implementation of the recommendations in a fair and objective manner. On the other, it is crucial to keep abreast of the evolving money laundering techniques in a rapidly changing international environment. These priorities are complemented by an integrated strategy designed to address systematically the interface with non-members and to coordinate efforts fully with other relevant international bodies in its pursuit of worldwide mobilisation against money laundering."[1232]

The moral/normative claims of the FATF rested on its goals of providing solutions to issues of transnational money laundering and protecting the soundness of the global financial system.

[1231] We have borrowed the terms 'institutional hardware' and 'institutional software' from Dryzek, J. S. 2002. *Deliberative democracy and beyond: liberals, critics, contestations.*Oxford: Oxford University Press.
[1232] . See FATF.1992. *Annual Report FATF 1991-1992,* Paris, 25 June 1992, pp. 18-21. .

Very few, if any, modern democratic countries would oppose these noble goals even if they are camouflaging narrow, hidden, and self-serving interests of dealing with issues of competition and arbitrage as discussed above. They resonate with similar other pressing global issues such as saving the environment, with which many progressive countries may be sensitive and sympathetic towards. A single politically incorrect word when dealing with these issues, even if merely questioning the strategies and methods that are being deployed to address them often elicits some emotionally charged rebukes and stigmatisation of those who seem to deviate from widely held or orthodox opinions. For instance, those dissenting with the FATF views, Daniel Drezner observed, risked being labelled as criminal havens or as "out of touch with reality".[1233] The FATF's cognitive claims were that it was the only body 'whose focus is exclusively money laundering' and it had the necessary expertise to bring about solutions to the problems that needed solving.

Its pragmatic claims were that developed countries had realised that there were no other ways to solve issues of money laundering in a globalised world than through cooperation at a global level. The hypocrisy of this cooperation arose, however, from the manner in which the FATF appears to have shunned the input of developing countries in its deliberative processes by excluding them from membership. According to the FATF, non-member governments had only to be 'sensitised' and 'made aware' that developed countries had taken this route and they should also follow suit[1234]. As also discussed by Hülsse[1235], using its discursive strategy of 'problematisation', the FATF not only painted money laundering as morally bad, but as damaging to every country's economy as crime was a global issue. According to this claim, money laundering could lead to continued underdevelopment for developing countries[1236]. Adopting

[1233] Drezner, D. W. 2005. Globalisation, harmonisation, and competition: the different pathways to policy convergence. *Journal of European Public Policy, 12*(5), 841-859.
[1234] FATF.1992. *Annual Report FATF 1991-1992*, Paris, 25 June 1992, p. 18-21.
[1235] H***ü***lsse, R. 2007. Creating demand for global governance: the making of a global money laundering problem. *Global Society, 21*(2), 155-178.
[1236] See also our discussion in Chapter 2, particularly our discussion of Bartlett, B. L. 2002. *The negative effects of Money laundering on economic development: countering money laundering in the Asian and Pacific region*. Regional Technical Assistance Project, International Economics Group, Dewey Ballantine LLP, London

AML standards was therefore patronisingly directed at protecting these countries from mainly self-harm and at encouraging their economic development[1237].

Over the years, it has not only been the FATF, as an organisation, that has faced a legitimacy crisis, but its standards have also been questioned as adequate means to combat crime and to protect the financial system against money launderers and terrorist financiers[1238]. The many flaws of the FATF standards remain largely unacknowledged by the group and appear to be largely ignored, often justified or explained away[1239]. The actions of the FATF of not seeking legitimacy, as it tried to extend its standards seem to confirm our private interest hypothesis that those who founded the FATF did not have the combating of crime as their primary motive, but rather that they instead used the powerful discourse of combating crime and protecting the integrity of the global financial system in order to govern narrow issues of competition.

The G7 countries, through forming the FATF, shifted the issue of money laundering from the UN which, although with its own structural flaws, had a far more heterogeneous representativeness and participation among countries than the FATF. In its 1992 Annual Report, the FATF wrote with regards to its membership that:

> "Any discussion of the role and identity of the FATF must inevitably involve taking a view on its own membership. The FATF now has twenty eight members. For an organisation that prides itself on its informality of procedure and ready ability to achieve consensus, this is clearly approaching the maximum membership possible.

[1237] See *ibid.*
[1238] See Chapter 7 regarding the outcomes of FTRs which show no convincing evidence of the successes of FTRs in South Africa and other countries (the US and the UK).
[1239] See discussion with Sharman, J.C. 2008. Power and discourse in policy diffusion: anti-money laundering in developing countries. *International Studies Quarterly* (52), pp. 635-656, where findings that the FATF standards were not mutually beneficial for developing countries he studied were allegedly changed by the funders of a research project he participated in in order to emphasise a need for the implementation of these standards even though they appeared to add no positive value.

> The FATF has, therefore, decided not to accept any new members for the time being"[1240].

To further cement this exclusivity, the FATF was offered in 1991[1241] secretariat services by the United Nations, an organisation with a broader membership through which it could reach out for participation. The FATF turned this offer down and instead approached the OECD, an exclusive organisation of mainly developed countries, for such services because the OECD had 'experience in areas related to those covered by the FATF: multi-disciplinary nature; and compatibility with the aims of the FATF'[1242]. This was however not clarified further. However, choosing to form a new body, rather than using more inclusive and broader forum of the UN is akin to what has been referred to as 'forum-shifting', where issues for deliberation are shifted to forums that are less likely to oppose them[1243].

Traditional legitimacy

To extend the regime to its non-members and to attempt to gain legitimacy, one of the strategies exploited by the FATF was to rely on age-old, neo-colonial and neo-imperial ties. This happened, notably, in extending the regime to the Caribbean and smaller off-shore jurisdictions and then to other parts of the world, particularly Africa-- a continent with deep colonial and imperial ties with some of the G7 countries. In its 1992 annual report, the FATF announced its strategy of getting non-members to support its standards. The FATF members, particularly the G7 countries, took it upon themselves to encourage the implementation of the FATF standards with "dependent, associate or otherwise connected territories with which they have constitutional,

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1240 See FATF.1992. *Annual Report FATF 1991-1992,* Paris, 25 June 1992, p. 18-21.
1241 *Ibid.*
1242 *Ibid.*
1243 See Woods, N. 2007. Global governance and the role of institutions. In D. Held & A. G. McGrew (Eds.), *Governing globalization: power, authority and global governance* (pp. 25-45). Oxford: Polity on 'forum-shifting'.

historical or geographical links"[1244]. Some of these 'dependent, associate or otherwise connected countries' were described by the FATF to form a diverse grouping which included "some significant offshore centres, and other areas of financial activity"[1245]. Despite the acknowledgment of these countries as significant areas of financial activity, they were deemed not to qualify for membership in the FATF and were accordingly excluded when the FATF decided to temporarily suspend accepting new members in 1992.

Instead those FATF members (or what the FATF called 'sponsoring countries') who had a 'constitutional, historical or geographical links' with these non-FATF 'dependent, associate or otherwise connected' countries, would serve as guardians or 'sponsors'. The FATF referred to them as 'sponsoring countries'[1246]. These were basically those countries that had historical or other forms of domination over non-member countries. It is these ties which were to be exploited to fashion some allegiance or buy-in into the FATF standards. The sponsoring countries, who were mainly the G7 countries, volunteered on behalf of the FATF, to use such traditional links of association or domination to extend its standards. This is akin to Max Weber's[1247] 'traditional' legitimation. Max Weber categorized legitimation under three-ideal types; 'charismatic', 'traditional' and 'rational-legal' authority[1248]. In a traditional system, according to Weber, orders to comply with old-age traditional norms or rules or patriarchal customs could play a role in gaining legitimacy. While Weber analysed a traditional system in sub-national, village, community or family contexts[1249], it could be used to analyse some developed-developing country relationships-- especially those with colonial, imperial or other 'dependency' or neo-colonial links in today's world. These relationships could be perceived as 'traditional', especially for the

[1244] FATF.1992. *Annual Report FATF 1991-1992*, Paris, 25 June 1992.
[1245] *Ibid.*
[1246] *Ibid.*

[1247] See Giddens, A. 1971. Capitalism and modern social theory: an analysis of the writings of Marx, Durkheim and Max Weber, Cambridge University Press, pp. 154-162.
[1248] *Ibid.*
[1249] *Ibid.*

dominant that have for years imposed their will on the weak by various means of control through colonial subjugation, imperial exploits and post-independence neo-colonial economic dependency.

In the case of the FATF, we argue that traditional/historical, colonial, neo-colonial or other dependency ties based on some old forms of 'centre-periphery' complexes whether economic, political or territorial were relied upon to try and gain support from non-members. The FATF could not gain 'rational-legal' or charismatic legitimacy as it was itself an informal, non-legally based club, run by some probably less known officials of the G7 countries whose world-changing charisma we have not yet heard of. However age-old ties have been persistent, fuelled mainly by neo-colonial economic dependency and 'third world' underdevelopment in a Western dominated capitalist world economy. Exploiting these old widely discredited colonial and imperial ties was an odd choice for seeking legitimation by the FATF. However this may not be an isolated incident for the many bodies founded through the channels of informal non-state groups of countries, especially the G7. These informal forums seem to have become a powerful locus for global decision-making. Their decisions can be followed through into international organisations such as the UN, EC, World Bank, WTO, and so on, where they become part of the international binding conventions or informal standards of such bodies as the Basel Committee on Banking Supervision (formed by the G10) and the Financial Stability Review (G20).

Using 'traditional' dependency ties, in the early 1990s, the FATF reported triumphantly that in the Caribbean, 'with the support of the FATF sponsoring countries (Canada, France, the Netherlands, the United Kingdom and the United States), a permanent secretariat for the Caribbean Financial Action Task Force (CFATF) has now been established'[1250]. This body was to be a vehicle for the transfer of the FATF standards into these 'dependent, associate or otherwise connected' Caribbean countries. Many of these countries had been stigmatised as 'regulatory havens' that posed a great risk of money laundering by the FATF. Endorsing the FATF standards to the extent of establishing a quasi-FATF body would appear to be a voluntary and a mutually inclusive

[1250] FATF.1994. *Annual Report FATF 1993-1994*, Paris, 16 June 1994, p. 1-10.

process. However using dependency and other similar ties of subordination, these countries may have been left with little choice but to oblige. Hülsse has argued, for instance, that although developing and small financial centre jurisdictions were legally free to ignore the FATF standards, it could not have been a very wise move for them to do so[1251]. He explained that;

> "The fact that they (non-FATF countries) depend on the member countries of the FATF in a number of ways means that turning against them in the realm of money laundering could quickly become disadvantageous in other issue areas. Hence, there surely exists a shadow of hierarchy, which explains why non-member countries comply even in the absence of explicit threats and coercive measures. Yet *voluntary* compliance hardly seems the correct label for such rule following behaviour."[1252]

We fully agree with Hülsse's argument here. The CFATF was just the first 'sponsored' body to be established by the FATF sponsoring countries. Other regions such as Asia, Latin America, Eastern Europe, and Africa followed. In Southern and Eastern Africa, for instance, the sponsoring countries used the Commonwealth, which refers to itself as the 'family of nations'. The Commonwealth is made up of mainly former British colonies and was used to spread the word and seek compliance with the FATF standards[1253]. In a conference held in South Africa in 1996, organised and sponsored by the Commonwealth and the FATF, a decision was taken to form the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG), a body similar to the CFATF, to convey the FATF standards to these countries[1254].

[1251] Hülsse, R. 2009. Even clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended. *Regulation and Governance*, Vol. 2, 459-479.
[1252] *Ibid.*.
[1253] In the early 1990s only the UK, Australia, New Zealand, Canada and Singapore were members of the FATF out of over 50 Commonwealth members.
[1254] A conference funded/organized by the FATF and the Commonwealth Secretariat was held in Cape Town, South Africa (on 1-3 October 1996) where 13 Southern and Eastern African countries attended. In attendance were Botswana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. Other major FATF member countries were also in attendance including the UK, US, Australia, Canada and the topic of the conference was adoption and observance of FATF standards. It was in this conference that these African countries should enact AML legislation based on the FATF standards and the

ESAAMLG was finally established and launched in 1999 in Tanzania as a FATF-style regional body of 14 Southern and Eastern African countries[1255]. From June 1990 to the end of 1996, the FATF claimed to have participated in or organised 44 conferences and missions with FATF non-members, to encourage adoption and implementation of its standards[1256]. While the FATF was generally satisfied with its progress on awareness-raising and was, as it claimed, gaining support and willingness for the adoption of its standards, it later claimed that many countries and territories were unwilling to cooperate[1257]. In 1996, it adopted a policy of assessing compliance with its standards by non-member governments[1258].

Naming and Shaming: the NCCT blacklists

It is this policy of assessing its non-member governments that provoked its legitimacy crisis, especially when applied to states linked through some dependency ties. Countries would through the sponsored Commonwealth conferences and workshops (or what J.C. Sharman refers to as 'seminar diplomacy'[1259]), pledge support to the standards, it seems, but not move swiftly to enact laws and regulatory provisions to comply with the standards. Using a policy of evaluation on non-member states, the FATF started publishing its findings and applying its naming and shaming techniques in the middle of 2000. Between 2000 and 2003, the FATF blacklisted a total of 23 so called Non-Cooperating Countries and Territories (NCCTs), who all were not its members. Many of these countries belonged to the CFATF, but also Russia, Israel, Egypt and

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Commonwealth model laws. Another major agreement was the formation of the 'Southern and Eastern African Financial Action Task Force' through which, as had been done a couple of years earlier with the Caribbean countries, they could facilitate the observance of FATF standards as non-members. See FATF.1997. *Annual Report 1996-1997*, FATF Secretariat, OECD, Paris. June 1997, pp22-27.

1255 FATF. 2000. *Annual Report 1999-2000*. FATF Secretariat, OECD, Paris. 22 June 2000,

1256 FATF. 1997. *Annual Report 1996-1997*. FATF Secretariat, OECD, Paris. June 1997, pp. 22-27.

1257 See *ibid.*

1258 *Ibid.*

1259 Sharman, J.C. 2008. Power and discourse in policy diffusion: anti money laundering in developing countries, *International Studies Quarterly* (52), 635-656.

Lebanon were on the list[1260]. In the following year, four jurisdictions (Cayman Islands, Liechtenstein, Panama and Bahamas) were delisted after having taken steps to implement the standards[1261]. A couple of other new countries (Indonesia, Guatemala, Hungary, Myanmar, Nigeria, (2001) Grenada and Ukraine (2002)) were also added to the blacklist[1262].

The blacklists entailed the FATF naming and shaming these countries and demanding that they make specified reforms in line with its standards. These sanctions were contained in Recommendation 21 of the standards which required financial institutions in FATF member countries to "give special attention to business relationships and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply the FATF Recommendations"[1263]. When these countries did not comply as required by the FATF, 'countermeasures', which are basically economic sanctions contained in Recommendation 22, could be applied. The countermeasures had the effect of restricting or cutting off international financial transactions-- thus affecting cross border transactions to and from them with the richest developed countries (FATF members). Countermeasures were only applied against Nauru and Myanmar, as they failed immediately to respond to FATFs demands after they were blacklisted[1264]. The countermeasures were lifted again when these countries relented and passed legislation to comply. By 2006 all countries had been removed from the blacklists and the FATF suspended its blacklisting campaign[1265]. However the suspension appears to have been temporary as the FATF

[1260] In 2000, the following countries were blacklisted; Bahamas, Cayman Islands, Cook Islands, Dominica, Israel, Lebanon, Liechtenstein, Marshall Islands, Nauru, Niue, Panama, Philippines, Russia, St. Kitts and Nevis, St. Vincent and the Grenadines. See FATF. 2000. *Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures*, 22 June 2000, Paris: FATF Secretariat, OECD., p.12

[1261] See FATF. 2001. *Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures*. 22 June 2001. Paris: FATF Secretariat, OECD p.18

[1262] *Ibid.* See also FATF. 2002. *Review to Identify Non-Cooperative Countries or Territories: Increasing the Worldwide Effectiveness of Anti-Money Laundering Measures*, 22 June 2002, Paris: FATF Secretariat, OECD. p.19.

[1263] FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. Paris:.FATF Secretariat, OECD.

[1264] FATF. 2007. *Annual Review for Non-Cooperative Countries and Territories 2006-07*: *Eighth NCCT Review.* 12 October 2007. Paris: FATF Secretariat,/OECD.p13.

[1265] *Ibid.*

continues to name and shame such countries as Iran and the People's Democratic Republic of Korea on an ongoing basis[1266].

Blacklisting is believed to have been a very effective tool of spreading the standards to non-members. It has also been viewed by those countries at the receiving end and many scholars as highly illegitimate and with no basis in law. Many scholars have covered blacklisting as a direct coercive tool of securing compliance. Rainer Hülsse has covered this aspect very admirably concerning issues of compliance. He argues that although coercion led to a high level of compliance, such compliance should be viewed as just 'formal compliance', which does not guarantee the effectiveness of the standards themselves or 'actual compliance'[1267]. Following the blacklists, many other non-FATF countries that were not blacklisted are believed to have engaged in 'pre-emptive compliance'; that is adopting the standards in order to avoid blacklisting[1268]. This was the case in South Africa where the government moved swiftly to introduce a piece of legislation which had been drafted in 1996 and only introduced in parliament towards the end of 2000 and then swiftly passed as the Financial Intelligence Centre Act in 2001[1269].

However it is important to acknowledge that perhaps many countries were eventually going to adopt the standards, even without the blacklists. This might have taken longer and could possibly have been done more cautiously by such adopting countries, taking into consideration their interests, the costs and benefits including the possible negative impact of such standards under their socio-economic circumstances. Some countries might have well chosen not to implement some aspects of these standards altogether, had they had a choice and a chance to evaluate their

[1266] See FATF Public Statement, 25 February 2011. https://www.fatf-gafi.org/document/11/0,3746,en_32250379_47221771_1_1_1_1,00.html & FATF's Public Statement , 25 February 2009. https://www.fatf-gafi.org/dataoecd/18/28/42242615.pdf, where the FATF names several countries including Iran, North Korea, Pakistani, Uzbekistan, among others. accessed in March 2011. TOO VAGUE A DATE

[1267] Hülsse, R. 2009. Even Clubs can't do without legitimacy: why the anti-money laundering blacklist was suspended, *Regulation and Governance*, Vol. 2, 459-479.

[1268] *Ibid.*

[1269] See Chapter 5 for a detailed analysis of how South Africa incorporated the FATF standards.

possible negative impacts. We have so far focussed on the FATF and how it sought to spread the regime without any credible attempts at gaining legitimacy. The question that arises out of this is why the FATF avoided all credible avenues of legitimation. Why would it not attempt more credible avenues of legitimation, such as inclusiveness, democracy, and respect for sovereignty, but rather chose the opposite?

In order to answer these questions we need to invoke our private interest hypothesis which brings the hidden motives for the emergence of the FATF and its standards to the fore. According to this hypothesis, the regime was not established to deal with issues of crime combating, but competition issues (regulatory and tax arbitrage). These were not so much issues of crime, but issues of competitive advantage which could not be dealt with as speedily through diplomatic channels or other more inclusive international organisations because they could lead to disagreements and delays. Merging them with the rhetoric of crime appears to have been a means to camouflage the real interests behind the dissemination of the regime. That some of these regulations could perhaps assist on issues of money laundering and now counter-terrorist financing was, in large part, a coincidence.

The financial regulatory measures have, on their own, been very weak when it comes to detecting crime -- not only in developing countries, but also in developed countries[1270]. The suspicious transaction reports which emanated from the regulation of businesses have not been shown to yield much output when it comes to detecting money launderers and terrorist financiers that we are told threaten the stability of the financial system. The failure of FTRs regimes has, as discussed in Chapter 7, led the US and the UK to review the effectiveness and efficiency of their regimes several times. These reviews have largely emanated from frustrations on the part of both the regulated businesses and governments. The several US and UK enquiries were established

[1270] See, for instance, Geiger, H., & Weunsch, O. 2007. The fight against money laundering: an economic analysis of a cost-benefit paradoxon. *Journal of Money Laundering Control*, 10(1), 91-105 on how even developed countries are struggling to assess the benefits of the AML regime; a point also argued aggressively in Chapter 7 .

because businesses were making complaints about the costs of regulation and they were demanding some accountability[1271].

Had the FATF sought credible legitimation before attempting to disseminate the regime, it might have faced opposition or might have been ignored, not because such countries necessarily supported criminals, money launderers and terrorists or cared less about the integrity of the global financial system, but because such measures were ultimately aimed at eliminating their competitive advantage, especially in respect of the so-called regulatory and tax havens. In order to unroll these regulatory measures speedily, the FATF therefore did not seek legitimacy, but relied on power. This explanation offers us more plausible reasons as to why the FATF may not care so much about the implications and the negative outcomes of these business regulations on developing countries.

In his work, *Power and Discourse in Policy Diffusion: Anti-Money Laundering in Developing Countries*, Jason C. Sharman[1272] narrates a story of how, after being commissioned to conduct a study in Barbados, Vanuatu and Mauritius, an unnamed commissioning organisation expected legitimating findings about the global AML standards. He wrote that

> "The finding that AML standards had a significant net negative impact on these three developing countries generated a hostile response from the organisation funding the study, as well as from all developed countries providing feedback. The objection was that such a conclusion could jeopardise the further diffusion of AML standards in the developing world, and thus that the findings should be re-written to reflect this imperative."[1273]

[1271] See Chapter 7.
[1272] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti money laundering in developing countries, *International Studies Quarterly* (52), 635-656.
[1273] *Ibid.* p.643.

Altering research findings to reflect a point that is contrary to them should be viewed with some level of scepticism. This is all the more true when the real and hidden motives behind the diffusion of the FATF standards, as we have argued, seem to have been accomplished at all costs, even if detrimental to the receiving countries. The countries behind the global diffusion of the regime appear not to have cared about the negative impact of this regime on the receiving countries, as long as it served the narrow interests for which the FATF was created. This is not an isolated incident, but a common feature of neo-liberalisation, where models of good governance are imposed on developing countries in a variety of ways and sometimes with grave socio-economic consequences[1274]. The administering of structural adjustment programmes by the IMF on developing countries over the past couple of decades has led to vicious cycles of debt, poverty and underdevelopment, which the main donor countries seem to exploit to further maintain the status quo of the industrialised countries over those of the poorer developing world.

Our private interest hypothesis helps us to explain why the FATF chose to be undemocratic and not to engage in any credible attempts in legitimating itself. Although the FATF has created a number of FATF-style regional bodies (the so called FSRBs) to try and portray an inclusive quasi-membership, such structures, at the beginning, were nothing more than mere vehicles of extending, imposing, and now preserving the regime. Now we turn to look at South Africa in order to explain why it will continue to implement the regime even if it shows no signs of being effective and efficient in detecting crime. In doing this, we also argue that the regime will not just continue to be inefficient and ineffective, but may lend itself to abuse either by local politicians who may want to settle political scores or by foreign powers. The latter may indirectly seek to manipulate the national FIUs by gaining access to politically sensitive transactions for purposes of 'regime change' or for influencing future power relations within satellite countries of interest. South Africa, like many other natural resource-rich but less-developed countries, is an interesting case for

[1274] See Stiglitz, J. E. 2003. *Globalisation and its discontents*. New York: W.W, Nortons & Company..

analysing issues of legitimacy, because of the vested Western interests in the natural resources of the country.

There are a number of justifications or factors that may today give the global FATF and its standards some semblance of legitimacy. In Chapter 5 we explained how the regime was adopted in South Africa. Our main finding was that South Africa was coerced into adopting the FATF standards in order to pre-empt a real threat of being blacklisted, as other countries had been, under the NCCT campaign. We also found that even without the FATF pressure, South Africa was eventually going to adopt the standards. The question, however, is whether South Africa would have adopted a different regime to the one it did under pressure from the FATF. In other words, did the South African authorities know that adopting the FATF standards, through emulating developed country models of KYC/CDD, would lead to unintended and undesirable consequences of financial exclusion?

According to Louis de Koker, South African authorities did have an appreciation of the potential negative impact of KYC/CDD[1275]. However, they might have had imperfect information on the actual impact since the regulations were new and no developing country lessons could be drawn on. The countries from which the SALRC borrowed were all developed economies which did not have the exact socio-economic underdevelopment dilemmas of South Africa and other developing countries. To this end, when FICA was passed, it had regulatory exemptions (the initial 'exemption 17') which attempted to waive regulatory compliance with the KYC/CDD so as to minimise the risk of financial exclusion[1276]. But the initial exemption 17, according to de Koker,

[1275] De Koker, L. 2008. *Money laundering and terror financing risk management of low risk financial products and services in South Africa: a report prepared for FinMark Trust*. The Centre for Financial Regulation and Inclusion (CENFRI), May 2008, p.3.
[1276] *Ibid.*

did not work[1277]. According to him the exemption 'was not of much practical use or did not shield potential poor clients from unwarranted FICA impact'[1278].

With the introduction of the 'Mzansi Banking Account Initiative' in 2004, a new exemption 17 was promulgated[1279]. These regulatory exemptions and similar other measures put in place to mitigate the risks of financial exclusion have gained some recognition from the FATF following the passing of its first ever policy on developing countries in 2008[1280]. South Africa was therefore aware of the potential dangers of KYC/CDD and did try to put mitigation measures in place. There was, however, lack of guidance from the FATF on how developing countries should deal with KYC/CDD. This lack of guidance may have added enormous costs of implementing these standards for developing countries as they later, after satisfying the FATF's demands to incorporate the regime, had to take steps to rectify or find a more suitable KYC/CDD regulatory design for their socio-economic circumstances.

Contesting legitimacy

It is our view that non-member countries of undemocratic bodies such as the FATF should challenge such bodies until they have reformed themselves to be more democratic. However, this cannot be achieved without any form of coordination and organisation among such aggrieved countries, especially when they face an organised group of countries such as the G7, which has the capability to use its economic power. However many countries who were directly (through the NCCT blacklists) or indirectly (through pre-emptive compliance) coerced to adopt the FATF

[1277] *Ibid.* See also Bester, H., de Koker, L., & Hawthorne, R. 2003. *Legislative and regulatory obstacles to mass banking*. FinMark Trust, G:enesis Analytics Pty Ltd, Johannesburg, South Africa.
[1278] De Koker, L. 2008. *Money laundering and terror financing risk management of low risk financial products and services in South Africa: a report prepared for FinMark Trust*. The Centre for Financial Regulation and Inclusion (CENFRI), May 2008, p.17.
[1279]See Chapter 6 .
[1280] See FATF. 2008. *Guidance on capacity building for mutual evaluations and implementation of the FATF standards within low capacity countries*, Paris: FATF/OECD..

standards did not make any coordinated attempts to challenge the FATF. Those who did individually resist risked huge economic costs. Jason Sharman has recounted the story of Nauru.

> "...the Pacific island of Nauru had point-blank refused to accept the FATF's ultimatum unless it was compensated to the tune of $10 million. The effect of the FATF blacklist led to a de facto financial blockade by private institutions and the complete collapse of the country's financial system. Currently, Nauru has not a single functioning bank, and the country has so successfully been stigmatized that now, even after complying with the FATF's demands, no bank is willing to take the reputational risk of opening a branch in the country"[1281].

The economic damage caused to Nauru by this blacklisting and incorporation of the FATF standards seems not to matter to the FATF and its founders. What this shows it that the lack of a coordinated effort by developing countries did rather make individual defiance against the powerful and organised interests unsustainable. Nauru was stigmatised despite the absence of any empirical evidence which suggested that money launderers may have used it more than they used those countries that were not stigmatised. While developing countries should ideally defend their freedom, many structural factors linked to their immediate interests or vulnerabilities (particularly economic dependence) may seem to coalesce and blur the bigger picture of their fight for equal treatment and involvement in global policy making.

Submitting to FATF's legitimacy claims

We have to acknowledge that the FATF did invite a few developing countries to become its members when it again reviewed its membership position in 1998. Three of these (Argentina,

[1281] Sharman, J.C. 2008. Power and discourse in policy diffusion: anti money laundering in developing countries, *International Studies Quarterly* (52), 635-656.. p. 645.

Brazil and Mexico) were given membership in 2000, while South Africa, Russia, India and China were invited later, after the FATF had resumed its blacklisting campaign. Russia is the only country from those that were blacklisted that ended up being invited for membership. Both these factors point to some reasonable justification for the incorporation of the FATF standards by these countries as they were already being offered membership. The invitation and acceptance of membership by these countries would appear to have given the FATF some form of ex-post legitimation. This had a further confirmatory effect on its standards which these countries had already domesticated prior to their formal inclusion as members[1282]. (Many other countries were made members of the so-called FATF-style regional bodies (FSRBs), with FATF members or the so-called 'sponsoring countries' overlooking/supervising their compliance). Since these countries had already legitimated these standards by making them national laws, it therefore made some sense for them to join the FATF and to try and influence change from within— especially concerning the implementation of these standards in developing countries.

There is a strong view that developing countries need to participate in these global forums to try and influence change from within. Those who encourage this view believe that it is precisely because these countries are excluded that they need to push for inclusiveness in these forums in order to advance their interests. Giandomenico Majone has, for instance, observed and argued that "..the importance of these international organisation is growing continuously, and no government can afford to ignore them or to be a purely passive member"[1283]. Issues of democracy affect not just non-state, but other more inclusive international organisations, such as the UN where the Security Council voting rights are skewed in favour of developed countries. However, to expect developing countries to disengage from all these institutions based on strict adherence to principles and values of democracy, sovereignty and legitimacy would be somehow unrealistic. Instead

[1282] All these countries (Brazil, Argentina, Mexico, South Africa, Russia, India, and China) had to undergo a mutual evaluation before becoming full members of the FATF. The Mutual Evaluation which resulted in South Africa being admitted as a member was conducted by the IMF in 2003.
[1283] Majone, G. 2003. The internationalisation of regulation: implications for developing countries. Paper presented at the International Conference on *Innovation and Change in Regulation and Competition*, 13-15 October 2003, Mandaluyong City, Metro Manila, Philippines, pp. 1-24, p. 3.

developing countries should strive for inclusiveness. It is when they are inside these institutions that they could bargain and influence global policy-making. The participation of South Africa and other developing countries in the FATF might have facilitated some change in the manner in which the FATF conducted itself and, perhaps, now thinks about its standards, especially with regards to their implementation in developing countries. It might also have been the FATF's strategy to seek ex-post legitimation once its goal of diffusing the regime had already been achieved.

In 2008 the FATF acknowledged for the first time that developing countries needed to implement the regime in a manner that did not lead to unintended consequences of financial exclusion[1284]. This acknowledgement did not come automatically, but followed from the Genesis and the CGAP research that we referred to earlier (see Chapter 1 and 5 and 6) which showed that implementing strict KYC/CDD measures in developing countries had its own negative implications. As shown in Chapter 6, these experiences and solutions of regulatory exemptions do not yet fully shield those who might be negatively impacted by the KYC/CDD regulations in areas of access to banking but do go some way in minimising the risks of financial exclusion. We now turn to the concluding part of this Chapter where we offer an explanation as to why South Africa, and many other developing countries that might be in a similar position, will continue to implement the global FATF standards of financial regulation despite lack of evidence as to their effectiveness and efficiency in the detection and combating of crime.

Why developing countries continue to implement the FATF standards?

It appears that there is one overarching reason for the continued implementation of the FATF standards. This reason is that the FATF standards have been merged with the neoliberal structural adjustment programmes of the IMF and the World Bank (the International Financial

[1284] See FATF. 2008. *Guidance on capacity building for mutual evaluations and implementation of the FATF standards within low capacity countries*, Paris:. FATF/OECD.

Institutions (IFIs))[1285]. It is important to show how the FATF standards have become part of the IMF/World Bank conditions for loans and aid. The FATF standards, together with many other financial regulatory and supervisory standards of similar non-state transnational bodies, have become the new structural adjustment programmes overseen by the IFIs. Alexander, et al., have meticulously analysed the role of these non-state bodies, which they refer to as "international financial supervisory bodies", in setting regulatory and supervisory standards[1286].

In their work *Global Governance of Financial Systems*, they analyse how some of these bodies, particularly the BCBS, FATF, IOSCO, IAIS and their standards are being used by IFIs to set 'conditionalities' and minimum standards that need to be observed and complied with by governments and market players[1287]. Making these various forms of standards part of IFI 'conditionalities' and financial surveillance programmes have effectively made them more mandatory and institutionalised even beyond the blacklists that the FATF utilised to demand compliance. The FATF standards became part of the IFI programmes in 1999 when the IMF and the World Bank started the Financial Sector Assessment Programme (FSAP)[1288]. This joint programme is aimed at evaluating the IFI members (about 185 countries) on the implementation and compliance with the 12 different sets of global standards and codes made by a variety of these standard setters. These currently include, among others, the standards of the BCBS, IOSCO, IAIS, and the IFIs themselves[1289].

The list of standards, codes and principles[1290] are as follows; IMF's, *Special Data Dissemination Standard/General Data Dissemination System* (SDDS/GDDS- (data

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[1285] See Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York: Oxford University Press.
[1286] *Ibid.*
[1287] *Ibid.*
[1288] *International Monetary Fund Factsheet: Financial Sector Assessment Program*, Washington, March 2010. http://www.imf.org/external/np/exr/facts/pdf/fsap.pdf
[1289] *Ibid.*
[1290] *International Monetary Fund: List of Standards, Codes and Principles Useful for Bank and Fund Operational Work and for which Reports on the Observance of Standards and Codes Are Produced*, Washington, November 2002. http://www.imf.org/external/standards/scnew.htm

transparency)), *Code of Good Practices on Fiscal Transparency, Code of Good Practices on Transparency in Monetary and Financial Policies*; the Basel Committee's *Core Principles for Effective Banking Supervision*; IOSCO *Objectives and Principles for Securities Regulation*, the IAIS *Insurance Supervisory Principles*; the Committee on Payments and Settlements Systems (CPSS) *Core Principles for Systemically Important Payments Systems*; CPSS-IOSCO Joint Task Force's *Recommendations for Securities Settlement Systems*; FATF's *40+9 Recommendations*; OECD's *Principles of Corporate Governance*; International Accounting Standards Board's *International Accounting Standards*; International Federation of Accountants' *International Standards on Auditing*; and the World Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*.

The FSAPs evaluate IMF members' financial sectors[1291]. The IMF does these assessments under Article IV and this involves consultation of its Articles of Association in jurisdictions with financial sectors it deems to be 'systemically important'[1292]. In these countries the IMF's Article IV financial stability assessments and surveillance takes place every five years and are mandatory[1293]. For other jurisdictions (or the less systemically important jurisdictions), FSAP assessments are allegedly 'voluntary'[1294]. While these are conducted by the IMF in developed countries, in developing and emerging economies they are conducted jointly by the IMF, focussing on financial stability, and the World Bank which does financial development assessments[1295].

These assessments result in reports which are published on assessed countries known as *Reports on Observance of Standards and Codes* (ROSCs) and *Financial System Stability Assessment Updates*. These reports are one of the sources used by private Credit Rating Agencies

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[1291] See *International Monetary Fund Factsheet: Financial Sector Assessment Program*, Washington, March 2010. http://www.imf.org/external/np/exr/facts/pdf/fsap.pdf. For an analysis on this see Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York: Oxford University Press. p 87-100.
[1292] See *International Monetary Fund Factsheet: Financial Sector Assessment Program*, Washington, March 2010. http://www.imf.org/external/np/exr/facts/pdf/fsap.pdf.
[1293] *Ibid.*
[1294] *Ibid.*
[1295] *Ibid.*

(CRAs) (such as Moody's, Standards & Poor and Fitch-IBCA) to assign a credit rating to sovereign and private sector borrowers of a country for debt issuing purposes in the capital markets[1296]. This means therefore that if countries do not comply with some of these standards, sovereign and private sector borrowers may have unfavourable ratings which can adversely affect their ability to raise or issue debt at affordable rates. Developing countries and their private sector institutions rely heavily on foreign investments and IFIs in raising capital. As explained by Ferri et al., credit ratings offer financial markets an estimate of the probability that borrowers will not fulfil their obligations in their debt issues[1297]. Financial markets further rely on CRAs constantly to update credit ratings they have assigned to issuers[1298]. When the ratings are low, issuers pay higher interest rates, embodying larger risk premiums than high-rated issuers[1299]. Ms. Lerato Mokhesi of the SARB's Banking Supervision Division told us that

> "Although the FATF standards are not binding in the strict sense of the word, they are binding because compliance to FATF standards or lack thereof affects your [credit] rating as a country. Remember that the World Bank and the IMF conduct what they call the Financial Sector Assessment Programs, the FSAPs. In according a rating to a country they do recognise the level of compliance of your country or lack thereof with the FATF and other standards. So though they may not be binding on a strict sense, they do affect your rating as a country…"

The Director of South Africa's Financial Intelligence Centre, Mr. Murray Mitchell, explained the importance of adhering to international standards in parliament while presenting his organisation's annual report. Referring to the FATF standards and their benefit to South Africa, he said;

1296 Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York: Oxford University Press. p 87-100.
1297 Ferri, G., Lui L.-G. & Stiglitz, J.E. 1999. The procyclical role of rating agencies: evidence from the East Asia Crisis. *Economic Notes: Review of Banking, Finance and Monetary Economics*, Vol. 28, Wiley-Blackwell, p335-355.
1298 *Ibid.*
1299 *Ibid.*

> "The benefit of this system (FATF standards) essentially...centres around good governance and integrity of...financial institutions and the business community...the system is designed to protect the integrity of that financial community- to lead to market stability, ultimately...it's a component part of reducing the costs of borrowing; credit rating, in other words. It ultimately increases investor confidence, and then banks with integrity have the ability to then transact and transact internationally...South Africa is a member of the FATF and membership means a country has committed itself at a political level to work within the FATF and aligns itself to FATF policies. This includes implementing the best standards and practices within the country and to also enable this to happen in the region. It also means implementing FATF decisions."[1300]

A number of issues are highlighted by this statement concerning South Africa's rationale for implementing the standards. However, the emphasis here is that the FATF standards are viewed as "a component part of reducing the cost of borrowing" or "credit rating". That appears to be the main legitimating reason for them. As Murray Mitchell further states in the same presentation, issues of financial integrity and credit rating "are a component of the tranche of issues that the Minister of Finance will be responsible for in order to ensure that financial systems work as a foundation for economic and social development within the country". He continued to enlighten the MPs that

> "These same issues apply [not for just banks but] for financial institutions. Certainly we would want those institutions in our country to have the utmost integrity...They too benefit from the process. So it becomes a dynamic interaction between the institutions and the governance structures within the country. The law enforcement community benefits...by using the information [suspicious transaction reports] sent

[1300] *Financial Intelligence Centre's Annual Report Presentation*. 2009. National Assembly Finance Committee, 17 November 2009, Parliamentary Monitoring Group. Audio Recording, transcription by author.

> to it on organised crime, terror networks-- and obviously, this impacts on the levels of financial crime in the long term."[1301]

We get from this statement therefore that in the short term, the FATF standards impact on the country's credit rating and, in the long term, "on the level of financial crime". However, as shown in Chapter 7, more than 90,000 FTRs were reported to the FIC and thousands referred to LEAs. Of all these FTRs only 4 convictions could be linked to them. This means that the FTRs measures have 'obviously' not impacted on 'financial crime'. After a long presentation by Murray Mitchel, one Member of Parliament exclaimed to him that

> "We are missing success stories here! May you be having a problem of getting how many of these cases that have been referred [by the FIC to law enforcement agencies] were favourably concluded?"[1302]

Instead of answering this question, Mitchell assured the members of parliament that South Africa was making headways and would soon start to produce results. He also lectured them that the country's regime was new - compared to those of other countries - and was not doing badly[1303]. On whatever assessment, the achievements of the FATF regime in South Africa and many other countries cannot be called effective and cost-efficient in detecting crime. The main legitimacy claim of the FATF standards and the reason why they continue to be implemented is that they are aligned to the FSAPs. They do not yet claim their legitimacy from their output as they appear to be not assisting in the detection of crime. This is however not a peculiar situation for South Africa and, probably, other developing countries. Evidence increasingly shows that many developed countries are struggling to identify tangible outputs of these standards when it comes to the fight against crime.

1301 *Financial Intelligence Centre's Annual Report Presentation*. 2009. National Assembly Finance Committee, 17 November 2009, Parliamentary Monitoring Group. Audio Recording, Transcription by author.
1302 *Ibid.*
1303 See Chapter 7 .

The several FTRs regime reviews carried out by the UK and the US governments, as discussed in Chapter 7, show clearly that even the originating countries are struggling to identify the positive outcomes of the FATF standards, despite their enormous costs to consumers as taxpayers and as patrons of regulated businesses. While the business community has often mounted challenges to the national regulatory regimes, calling for accountability of the standards, consumers have not. The latter group remains unorganised and cut out from any form of representation from the deliberative processes of the regime though they are the ones who ultimately fund it.

The FSAP programme has implications for countries needing to raise capital from the capital markets and also to those countries that rely heavily on the IMF and the World Bank for financial assistance and loans. The FATF standards have become part of the neoliberal structural adjustments and are being used as a yardstick or incentive for determining sovereign and private sector credit ratings by the international CRAs. The acceptance of FATF standards in developing countries are, therefore, due to these attached market incentives of maintaining a good credit record and minimising the costs of borrowing. Developing countries are generally vulnerable to neoliberal economic pressures of creating market-friendly environments which are believed to establish an attractive space for foreign direct investments. These neoliberal pressures are thought to be essential in driving social development and economic growth. As explained by Ferri et al., "besides affecting the cost at which issuers can borrow, ratings determine the extent of potential investors."[1304]

Non-adoption of these standards, therefore, does not only affect a country's credit rating, but applies in areas of extraterritorial regulation which are aimed at managing and minimising systemic risks in the global financial system and within countries[1305]. For instance, financial

[1304] Ferri, G., Lui L.-G. & Stiglitz, J.E. 1999. The procyclical role of rating agencies: evidence from the East Asia Crisis. *Economic Notes: Review of Banking, Finance and Monetary Economics*, Vol. 28, Wiley-Blackwell, p335-355.
[1305] Alexander, K., Dhumale, R., & Eatwell, J. 2006. *Global governance of financial systems : the international regulation of systemic risk*. New York: Oxford University Press. p 87-100.

regulators in G10 countries may require that foreign banks seeking a licence to operate in their jurisdictions come from jurisdictions which meet these standards[1306]. The merging of standards developed by private and non-state bodies with those of IFIs and market players (CRAs) create market (dis)incentives for (non)-compliance[1307]. It has indeed been observed that organisations, especially non-state, facing a legitimation crisis, tend to align their programmes with those of other bigger and more recognised organisations in order to build or repair their legitimacy[1308].

In aligning its programmes with those of the World Bank and the IMF, the FATF and its standards has become widely viewed as legitimate in South Africa. Most countries would therefore do their utmost to protect their sovereign and private sector lines of credit. However as known with other forms of neoliberal structural adjustment programmes of IFIs, which have left a trail of underdevelopment in many countries throughout Africa since being introduced a couple of decades ago, they have hardly led to the eradication of poverty and underdevelopment[1309].

Conclusion

In conclusion, this chapter has looked at issues of the legitimacy of the FATF regime in relation to developing countries. The interest of this study on developing countries was largely motivated by their exclusion in deliberative processes of the FATF and the coercive manner in which the FATF standards were imposed on them. The FATF has, after imposing these standards to more than 160 jurisdictions started to open up to issues of participation by extending membership to some developing countries and creating additional vehicles (the FSRBs) which it uses to spread and preserve the regime. All this ex-post inclusion of developing countries seems to be attempts aimed at repairing the FATF's credibility. However, the FATF and its founders

[1306] *Ibid.*
[1307] *Ibid.*
[1308] Black, J. 2008. Constructing and contesting legitimacy and accountability in polycentric regulatory regimes. *Regulation and Governance*, Vol. 1, No. 1, pp. 137-168.
[1309] Stiglitz, J. E. 2003. *Globalisation and its discontents*. New York: W.W, Nortons & Company.

deliberately did not seek legitimacy in the early years because they could not effectively spread their standards without their questionable practices of blacklists and of merging them with the neoliberal adjustment programmes of the IMF and the World Bank. This compels many countries to implement these standards even though they hardly address the problems which some may have genuinely believed to be in their interests and in the interest of their constituencies.

Summary and Recommendations

This work sought to determine why and how the global FATF regime emerged and was incorporated in developing countries -- using South Africa as an empirical case study of incorporation and implementation. This was in light of the view emerging from research conducted in Europe which pointed to a regime that has failed to achieve its goals of detecting money laundering and of protecting the global financial system from such alleged threats from money launders and terrorist financiers. This was done in the context of developing country socio-economic conditions of underdevelopment, which are markedly different to those of developed countries. This chapter draws the key conclusions reached mainly in the four findings in chapter 5, 6, 7 and 8 and makes some recommendations around the key themes tackled in them. It is the hope of this researcher that the findings and recommendations of this study will help the government of South Africa and other countries mainly in the developing world, policy makers, regulators and law enforcement agencies and academics who may pursue further research on some of the issues arising from this study.

Chapter 1 of this work introduced the topic of regulating money laundering in developing countries. It reviewed the background to the emergence of the global anti-money laundering regime which comprises hard (UN Vienna Convention of 1988) and soft (FATF standards) law features. We showed how the soft law FATF standards have ultimately become hard law through their infusion into binding international UN Conventions against organized crime, corruption and terrorism, among others. While the UN hard law components of the global AML regime focused on criminal law (criminalization of money laundering), civil law (asset seizure and forfeiture) and international cooperation (mutual legal assistance and extradition treaties), the FATF standards added an innovative pillar of financial regulation. It is the financial regulatory aspects of the global regime and their coerced diffusion and implementation that were the focus of the study. We explained that these were focused on in light of their coerced diffusion and aggressive implementation and the tensions they brought about under the socio-economic conditions of underdevelopment in developing countries.

In Chapter 2 we conceptualized and contextualised the business financial regulatory standards of the FATF through which governments have regulated different types of private businesses and professions to perform various anti-money laundering and counter-financing of terrorism functions. These include; the reporting of suspicious, unusual, cross-border and threshold transactions of customers to FIUs, the training of staff, the KYC/CDD regulations, record keeping and the appointment of Anti-Money Laundering Reporting/Compliance Officers. These regulatory measures required business to play an active role in the detection and combating of crime. We argued that the regulations are based on the situational crime prevention and risk regulation strategies. We highlighted the weaknesses of basing these regulatory measures on situational crime prevention and risk regulation strategies, especially in developing economies.

We argued that situational crime prevention bedevils the regime with fundamental flaws and may militate against the alleged objectives and goals of the regime as these regulatory measures do not necessarily help in the combating of crime but rather deflects it to unregulated sectors of the economy. We also argued that this problem of crime deflection may explain the incremental expansion of the financial regulatory regime from initially banks to other financial and non-financial institutions and professions. We further argued that this would ultimately lead to a costly and endless cycle of regulation where the list of regulated private businesses kept on expanding without any tangible evidence of its benefits. The major difficulty of this is that the regime may not only deflect crime to the informal sectors of the economy, which do not easily lend themselves to regulation, but may deflect large sectors of the population into using costly informal financial services and thus increase the already enormous transaction costs for the poor. We also stated our research questions and hypotheses.

Chapter 3 dealt with the theoretical framework. This was a study of financial regulations that are aimed at detecting and combating money laundering (and terrorist financing). They have transformed the manner in which law enforcement deals with crime by extending its roles to the boardrooms of private businesses. This has transformed the manner in which the regulated businesses operate by imposing law enforcement duties of policing and monitoring their customers. In light of this, we used the theories of regulation to determine why regulation emerges. With respect to regulation theory, two competing theories of regulation of public and private interest were discussed and led to the development of our competing hypotheses which guided our research design and methodology.

In Chapter 4 we discussed the South Africa's legal, regulatory and institutional framework against money laundering, We focused on three main pieces of legislation; POCA, FICA and POCDATARA, the regulations and the institutions that play a major role in the implementation and enforcement of the domesticated regime. We also looked at the jurisprudence that has developed, noting that there has been a tendency to over-apply measures aimed at dealing with organized criminal activities to other peripheral issues such as drunken driving. We observed that this over-application of laws directed at combating terrorism and serious organized crime has also been experienced in countries such as the UK, where the government froze the assets of Icelandic banks in the wake of the global recession in 2008. The over-extension of these laws to areas that they were not tacitly intended for may create problems of abuse and possible affront to civil liberties. We however noted that while the POCA has extensively been used by the AFU to seize proceeds and instrumentalities of crime, the other pieces of legislation have hardly been tested in court in South Africa. While the first four chapters laid a foundation for our empirical research, Chapter 5, 6, 7 and 8 started to test our competing regulatory hypotheses of public and private interest.

In Chapter 5 we examined the global diffusion and the incorporation of the FATF standards in South Africa, probing whether this served to advance their alleged public interest goals and objectives (of detecting crime and preserving the global financial system from abuse/misuse by criminal and terrorist elements) or rather to serve other narrow agendas of the G7 countries, especially the US, who pushed for the diffusion of the regime throughout the globe at all costs even through the use of force. We traced the development of the financial regulatory regime to the US in the early 1970s, showing that the US had expressed disquiet concerning regulatory arbitrage and desired other countries to implement similar measures in order to level the playing field. This led to the global spread of the US's financial regulatory regime which gained momentum with the formation of the FATF in 1989. This led to the diffusion of these regulatory standards to the so-called regulatory and/or tax havens and developing countries through the controversial campaigns of NCCT blacklists of the FATF, which many scholars have questioned. The NCCT blacklists were critiqued in light of the lack of a legal mandate by the FATF and given that these countries were deliberately excluded from the membership of the FATF and thus could not participate in the shaping of such regulations.

While many countries were not blacklisted, including South Africa, we nonetheless found that the FATF standards were adopted under some tremendous undue pressure. They were adopted in order to pre-empt a potential blacklist, as attested to by South Africa's then Minister of Finance, Mr. Trevor Manuel and others who warned, during FICA parliamentary deliberations, of South Africa's non-compliance with the standards and the consequent potential economic hazards[1310]. Another important finding is that although the standards were portrayed as voluntary soft law mechanisms and flexible to adaptation to various socio-economic conditions, the coercive manner through which they were extended cancelled that out. As a result of this forced adoption, the flexibility and adaptability of these standards to conditions of underdevelopment could not be appreciated, let alone acted upon promptly in order to mitigate their potential unintended consequences of financial exclusion. It was only during implementation that these tensions between the FATF standards, especially those of financial exclusion wrought by KYC/CDD, clearly came to the fore, leading to the necessary delays in implementing the regime, especially within the banking sector.

[1310] See Chapter 5.

Our main recommendation regarding global regulation is that where policy making is genuinely intended to solve global issues of concern, global forums - formal or informal, state or non-state - should at least be democratic and representative of developing countries in the earliest phases. This would help in bringing to the fore the pressing issues of developing countries. Excluding developing countries while over-representing developed countries may result in skewed policies which may perpetuate global inequalities between developed and developing countries and national inequalities. They may tend further to alienate the poor in these countries and perpetuate the ever-widening socio-economic inequalities.

We showed this in Chapter 6 with the implementation of KYC/CDD regulations within South Africa's banking sector. We found, as other recent studies[1311] have, that South Africa had adopted a regime that was in tension with its socio-economic realities. These were conditions where more than 56% of its adult population had no bank account at the turn of the century and most of them could not meet the documentary requirements of KYC/CDD[1312]. We showed how around the same time that KYC/CDD regulations were being introduced, there were also widespread campaigns directed at the banking sector to reform and extend its services and infrastructure and to be more accommodative given its discriminatory and exclusionary tendencies under apartheid and well into the democratic dispensation.

[1311] De Koker, L. 2006. Money laundering control and suppression of financing of terrorism: some thoughts on the impact of customer due diligence measures on financial exclusion. *Journal of Financial Crime,* Vol. 13(1): 26-50, De Koker, L. 2008. *Money laundering and terror financing risk management of low risk financial products and services in South Africa: a report prepared for FinMark Trust*. The Centre for Financial Regulation and Inclusion (CENFRI), May 2008. Bester, H., de Koker, L., & Hawthorne, R. 2003. *Legislative and regulatory obstacles to mass banking*. FinMark Trust, G:enesis Analytics Pty Ltd, Johannesburg, South Africa CGAP .2008. *Notes on Regulation of Branchless Banking in South Africa*. CGAP Technology Program, Washington. CGAP. 2005. *AML/CFT Regulation: Implications for Financial Service Providers that service low income people*, Washington, DC (Jennifer Isern, David Porteous, Raul Hernandez-Coss and Chinyere Egwuagu) CGAP Focus Note No. 29. G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (authors: Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative.

[1312] G:enesis. 2008. *Implementing FATF Standards in developing countries and financial inclusion: findings and guidelines* (Hennie Bester, Doubell Chamberlain, Louis De Koker, Christine Hougaard, Ryan Short, Anja Smith and Richard Walker). Final Report, February 2008, First Initiative

The KYC/CDD requirements were on a collision course with such a campaign and forced the government to come up with regulatory exemptions (Exemption 17) in order to mitigate the unintended and undesirable consequences of financial exclusion. We found however that even though there are these regulatory exemptions, they are discretionary and some banks may waive them in order to exclude some population groups that fail to source the prescribed documentary requirements such as proof of residence. It is our recommendation that the South Africa government might, where feasible, make the application of regulatory exemptions compulsory to mitigate this risk of exclusion. To avoid all these problems that developing countries face when implementing international best practice standards, it is necessary for policy making at that level to be as inclusive and as representative as possible.

In Chapter 7 we focused on the outcomes of regulating private businesses to report customer transactions (FTRs) to FIUs. Our main finding was that the regime was neither efficient nor effective in assisting to achieve its alleged objectives, those of crime detection. Although any regime would have reasonable regulatory costs, it must also have some benefits- otherwise it constitutes bad and disproportionate regulation. Out of more than 90,000 FTRs that were filed with the FIC by regulated businesses since its formation to 2008, only 4 convictions had been achieved from investigations initiated by FTRs. LEAs were also generally of the view that the FTRs were not very useful in initiating new investigations, but sometimes assisted with providing information on ongoing investigations. We argued that the lack of positive benefits from this regime were rather disturbing given the costs that have been expended on it by government, regulated businesses and society - which funds the former two. We recommend that South Africa needs to do an independent review of its FTRs regime with a view to identifying where the problems lie and of making its regime efficient and effective. Such a review should track what happens to the FTRs that are received by the FIC, those that are referred to LEA, both locally and abroad.

Another finding in relation to the FIC and the FTRs regime is that the FIC receives raw FTRs from regulated business, but enhances them into intelligence before referring them to

LEAs[1313]. Although the FIC is referred to as an 'intelligence centre', it is not, in our view, an intelligence agency or organization in a legal sense. South Africa may need to relook at the accountability and oversight mechanisms of the FIC as it is involved in intelligence activities without the full requisite mechanisms that other national security and crime intelligence agencies are subjected to. This could assist in preventing any potential abuses of power by the Centre, although these issues are partially covered by Section 40 and 60 of FICA. Another recommendation is with respect to the keeping of information by the Centre. South Africa may look at introducing data protection laws (through its Protection of Personal Information Bill) and data retention regulations regarding the continued keeping and controlled destruction of personal information in the form of FTRs reported to it but which have, for a considerable period of time (perhaps 5 or 10 years), been neither used nor yielded any positive results.

In Chapter 8 we tackled the issue of legitimacy of the FATF and its standards. We argued that from the start, the FATF failed to build its badly needed legitimacy when it came to seeking compliance with its standards by developing countries. We showed how it used old discredited colonial and imperial, but yet effective, ties to try and extend its regime to non-FATF countries. This was followed by the naming and shaming blacklists, which worsened its legitimacy crisis. It then tried to repair its legitimacy by extending and merging its standards with those of stronger organisations such as the IMF and the World Bank. We argued that the merging of the FATF standards with those of the IMF and World Bank is the main reason why many developing countries would continue to implement the regime despite its failure to achieve the alleged public interest goals of combating crime. This is because they have become part of the whole package of standards that are taken into account by credit rating agencies in order to determine credit ratings for countries. Developing countries are therefore justified on these grounds to implement the regime. However, merging bad FATF regulations with other prudential regulatory measures does

[1313] See Chapter 7.

not make them effective in achieving their alleged primary objectives. It merely creates a regulatory burden for these countries.

In conclusion, it is important to emphasise that not all aspects of the global AML regime were imposed on South Africa. Some aspects appear to have come about in a rational attempt to develop South Africa's laws that deal with organized crime post-apartheid. Such aspects as asset forfeiture appear, in the main, to be working quite well given the outcomes of the AFU since its formation that we discussed in Chapter 7. It is the business regulatory aspects of the regime that need revisiting in order to ascertain why FTRs account for such a low number of successes. A cost-benefit analysis is important to ascertain whether the regime can still be rescued in the public interest. This is not out of much concern for regulated businesses, but for the ordinary consumer who funds the government and private sector compliance through increased transaction costs. Developing countries do need anti-money laundering and anti-terrorism laws and regulations, but they must be good laws. Where they are not achieving their goals or bringing about unintended and undesirable consequences, global standard-setters and national governments need to be open-minded and flexible to review their systems with the view to improving them.

Lastly, there can be other objectives attached to the AML/CTF laws, as long as such objectives are legitimate and are not aimed at achieving narrow interests at the expense of others, especially developing countries.

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Appendix 1.1: Categories of Participants Reached

Table 1: Categories of participants

Type of Institution	**Number of Interviewees**	**Rank or Job Position**
Private Banks	4 banks and 5 individuals	4 Group AML Compliance Officers 1 trainee in one of the 4 groups.
Regulatory Supervisory Body South African Reserve Bank	1	2 interviews
Regulatory Supervisory Body: Independent Regulatory Board of Auditors	1	Head of Compliance
Professional Association: South African Insurance Association (SAIA)	1	Manager
Professional Associations: South African Institute of Chartered Accountants	3	Group interview with Senior Manager, Researcher and Consultant from KPMG
Law Enforcement Agencies: SAPS, NPA, AFU, Commercial Crimes Unit	10	6 Directors- both investigations and prosecutions. 4 Middle level investigators.
Private Organizations: South African Banking Risk (SABRIC)	1	Director: Commercial Crime
Compliance & Risk Resources Pty Ltd. John Symington	1	AML compliance specialist
Mary De Haas	1	Sociologist based in Durban KwaZulu-Natal

Appendix 4.1: A short summary of some cases cited in Chapter 4.

National Director of Public Prosecutions v Kyriacou

In this case, a High Court Judge refused to make a restraint order on the grounds that the stolen property of about R4,5 million in the possession of the defendant had already been seized in terms Section 34 (1) (a) of the Criminal Procedure Act 51 of 1977 and paid back to the rightful owners. On top of this, the NDPP applied to the High Court for a restraint order, which was provisionally granted by Cillie J, pending the return of service. However on the return day, Judge Cillie J set the provisional order aside. He was of the view that no proper grounds had been established for making a restraint order because: 1. the 4.5 million stolen property had already been paid back to the rightful owners in terms of Criminal Procedure Act, and 2. it was highly unlikely that a confiscation order would be made against the defendant. On appeal by the state, Mlambo J, sitting at the Supreme Court of Appeal, held at par 11 that "A court that convicts an offender is not restricted to making a confiscation order in relation only to offences which the offender has been convicted…the Act authorizes a court to make a confiscation order once it has found that the offender has benefited either from an offence of which he has been convicted, or from any criminal activity which the court finds to be sufficiently related to those offences. A finding that the offender has benefited in any of those respects constitutes the jurisdictional fact that is necessary for a court to exercise its discretion to make a confiscation order.

S v Shaik and Others

Mr. Shabir Shaik and his companies had corruptly been given shares worth ZAR21 018 000. Over a period of time, dividends declared on these shares were to the value of over ZAR12 million. These dividends were used to acquire more shareholdings on another company. The question before the court was whether only the initial shareholding should be confiscated or the dividends as well. Shaik's counsel argued that the confiscation order was disproportionate in that the dividends should not be construed to form the proceeds of unlawful activities in terms of POCA.

National Director of Public Prosecutions v R O Cook Properties (Pty) Ltd

The summary and background of this case is in par 2 of the judgment and is as follows; "*NDPP v RO Cook Properties (Pty) Ltd* ('Cook Properties') concerns a suburban house in Randburg, Gauteng ('the property'). The owner (a private family company) let it under a written lease as 'a guest house'. The NDPP alleged that the lessees used it as a brothel 'in contravention of Section 20(1) of the Sexual Offences Act 31 of 1957'; and that persons kidnapped by one Michael Zinqi and his cohorts were assaulted and held hostage on the property. The owner opposed the application. In the Johannesburg High Court, Willis J found that it had not been proved that the property was an instrumentality of an offence and dismissed the NDPP's application".

National Director of Public Prosecutions v 37 Gillespie Street Durban (Pty) Ltd and Another

The summary and background of this case is in par 3 of judgment, as follows; "…the NDPP alleged that drug and prostitution offences were committed on the property, which was operated as a hotel known as 'the Blenheim' at 37 Gillespie Street in the Point area ('the hotel'). The respondents – a property-owning company the sole asset of which is the hotel and the bond-holder – anticipated protracted proceedings and so the owner applied for legal expenses to enable it to resist the forfeiture application. When this application came before Magid J in the Durban High Court, he insisted that the instrumentality question be argued first, since he thought that might dispose of the litigation. It did. He found that the NDPP had not discharged the onus of proving that the hotel was an instrumentality of an offence. He set aside the preservation order and dismissed the forfeiture application with costs…"

National Director of Public Prosecutions v Seevnarayan

The summary and background of this case is, in par 4 of judgment, as follows; "*NDPP v Seevnarayan* concerns investments totalling R4 115 738.58 that a taxpayer had made under false names with a life insurance company (Sanlam). His purpose was to conceal the moneys and their proceeds so as to evade income tax. The scheme came apart at the end of 1999 when, fearing millennial problems, he tried with the help of his attorney to withdraw the investments and Sanlam demanded authentic proof of identity. The conduct of the attorney, Mr Yusuf Mohammed Essack of Durban, was referred to the Law Society for investigation, while the NDPP sought forfeiture of the investments and the interest on them as instrumentalities of offences and proceeds of unlawful activities. Griesel J in the Cape High Court dismissed the application, holding that the money was not the means by which the frauds and tax evasion were committed, and that the NDPP had not shown that either the capital amounts or the interest earned were 'proceeds of unlawful activities'.

Appendix 4.2: Some notes and analysis on the interpretation of 'instrumentality of an offence' and 'proceeds of criminal activity' under POCA

Interpreting 'instrumentality of an offence'

Section 1 of POCA defines the phrase 'instrumentality of an offence' to mean "any property which is concerned in the commission of an offence". Such an event/offence might have occurred before or after the coming into force of POCA. Further, such an offence may have been committed within South Africa or anywhere else in the world. In interpreting this definition, Mpati DP and Cameron JA noted that it was too wide, but stated that the legislature intended it to be so. However, they opined that there has to be some restriction. They noted that a literal interpretation of this definition could

> "…lead to forfeiture of property whose role in or utility to a crime is entirely incidental to its commission, such as a public vehicle on which a passenger steals an item from another, or a building in whose recesses a fleeing criminal finds refuge, or a flat rented by a thief who stores loot under a mattress"[1314].

Mpati DP and Cameron JA argued that this 'unbounded literalism' would be inappropriate. According to them at par 13, the words 'concerned in' in the definition of an 'instrumentality of an offence' were never intended to be used in their 'wide, literal sense'. They then outlined two principles that guided their interpretation of the 'instrumentality of an offence' phrase. The first is the purpose of POCA and then the guiding principles of legislative interpretation as contained in the South African constitution. With regards to the former, they reasoned that POCA's purpose, as stated in its preamble, suggested some restriction to the 'instrumentality' phrase. The part of the preamble they particularly referred to is that which states that "…no…person (is) entitled to use property for the commission of an offence" (POCA Preamble)

They reasoned that the words 'use' of property 'for' the commission of an offence "denotes a relationship of direct functionality between what is used and what is achieved"[1315]. On par 14, and in the light of this direct functionality, they argue that the 'vehicle, building and flat posited in the examples earlier

[1314] See par. 12 of *National Director of Public Prosecutions v Seevnarayan*.
[1315] *Ibid.*

could not be said to have been 'used for' the commission of an offence'. According to them, the words 'concerned in the commission of an offence' must be interpreted so that

> "…the link between the crime committed and the property is reasonably direct, and the employment of the property must be functional to the commission of the crime…the property must play a reasonably direct role in the commission of the offence…the property must facilitate or make possible the commission of the offence…the property must be instrumental in, and not merely incidental to, the commission of the offence"[1316].

They further note that crime always occurs somewhere. Perhaps this quotation from Erasmus J, in an unreported case regarding instrumentality, succinctly clarifies that

> "Every [scheduled] offence must be committed on some piece of property. But it would be absurd to infer that the legislature had intended every property on which such an offence had been committed to be liable to forfeiture to the State. A closer connection must be shown than mere presence. It must be established that the property was 'concerned' in the commission of the offence, and not merely that the offence was committed on the property"[1317].

With regard to the second principle that Mpati DP and Cameron JA used to interpret the instrumentality phrase is the construction of the provisions of POCA in line with the South African Constitution, particularly the Bill of Rights. They note that Section 39 of the Bill of Rights in the South African Constitution requires that the courts, when interpreting statutes, promote the spirit, purport and objects of the Bills of Rights. In this light, they argue that a literal interpretation of an instrumentality of an offence, as discussed in the examples of a vehicle, building and flat above, would not be consistent with the Bill of Rights in the South African Constitution, which requires that 'no law may permit arbitrary deprivation of property'[1318].

[1316] See par 31 of National Director of Public Prosecutions v R O Cook Properties (Pty) Ltd (260/03) [2004] ZASCA 36 (13 May 2004).
[1317] *Ibid.*
[1318] See *Ibid*. par 15. See also (*The Constitution of the Republic of South Africa, Act No. 106 of 1996*). The South African Constitution is the supreme law of the republic and any law inconsistent with it would be declared unconstitutional by the courts, forcing the legislature to amend or repeal such a law. The South African political and legal regime subscribes to the principle of 'constitutional supremacy' as opposed to 'parliamentary supremacy'.

As a result of this analysis, Mpati DP and Cameron JA further reasoned that in determining whether property should be forfeit in terms of Chapter 6 of POCA, a two stage enquiry by the courts should be followed[1319]. The first stage is to ascertain whether the property concerned is indeed an instrumentality. At this stage, the property owners 'guilt or wrongdoing, knowledge or lack of it' is not the focus. What is important, at this stage, is to ascertain whether there is a functional relationship between the property concerned and the crime. The first stage may help determine whether such property was an instrumentality of the offence alleged, in the first place, or not. Where it is determined that the property is indeed an instrumentality, the second stage kicks in. The second stage involves the actual determination of whether such property concerned should be forfeit or not. The forfeiture would normally be automatic where no other party challenges the NDPP in his application for forfeiture. However, forfeitures have been widely challenged in South Africa. People lose such property fighting, or, in a number of cases, manage to defend their interests.

It is at this stage that anybody with an interest in the property concerned is given a chance to either oppose the forfeiture or to request that his/her interests be excluded[1320]. It is also at this stage where the court examines the culpability of those who have an interest in the property concerned. This is taken from the provisions of POCA (s 52 (2A)) which require that a party that opposes forfeiture or applies for exclusion of an interest shall state that s/he acquired the property legally and- (a) neither knew nor had reasonable grounds to suspect that the property in which the interest is held is an instrumentality… or (b) where the offence concerned had occurred before the commencement of POCA, the applicant has since taken reasonable steps to prevent the use of the property for the commission of the alleged offences.

This therefore means that those who apply for exclusion of their interest or oppose forfeiture have an onus to convince the court on the balance of probabilities. They bear the responsibility of defending their interests. This is bearing in mind that in Chapter 6 proceedings it is possible that no one could have been charged with any criminal offence. The respondents may defend their property by arguing and proving that they did not know or had no reasonable grounds to suspect that their property was being used to commit crime. If they knew or had suspicions, they must show that they took 'reasonable steps' to try and prevent

[1319] This two stage inquiry is attributed to Ackerman J in his judgment in the *Mohammed* case; *National Director of Public Prosecutions v Mohamed NO and Others*
[1320] Section 52 (1) (a) and s 48 (4) (a) and (b) of POCA

such illegal usage of their property, such as reporting their knowledge or suspicions to the police. These have become known as the 'innocent owner' and 'ignorant owner' defences.

For instance, a property owner who rents his property out may not be aware that his/her tenants are using the house to harvest or sell illegal drugs; therefore s/he is an ignorant owner. Or, s/he may have been informed by neighbours or someone else of such suspicions or knowledge of drug dealing by the tenants, which s/he was not involved in; therefore s/he would be an innocent owner. The property owner would in these instances have to prove on balance of probabilities that s/he did not know or that s/he did not have reasonable grounds to suspect and that s/he was not involved. However, it does not end there. S/he still has to show the court that, where s/he was innocent but suspicious or knew, s/he took reasonable steps to remedy or prevent the usage of his/her property in illegal activities. S/he may, for instance, say that s/he reported his/her knowledge or suspicions to the police and provide such details as a case or incident report number.

In the judgment by Mpati J and Cameron JA, the issue of reverse onus of proof and its constitutionality in POCA was never been dealt with[1321]. It still remains to be challenged in future cases. However, what POCA does in Chapter 6, is that it effectively regulates property owners to play an active role in ensuring that their property is not used to commit crime. This active role and responsibility may be problematic, especially in the absence of any guidelines or explicit regulations in this regard in POCA or the judgment by Mpati J and Cameron JA. Consider the example of a rented property owner above. He has been informed by some of the neighbours who reside where his/her property is located. The neighbours inform him that they suspect that his/her tenants either grow or sell drugs from the rented property. POCA does not specify what exactly the property owner needs to do when they come to know or suspect that their property is being used to commit crime. POCA just states that s/he may adduce evidence in his/her forfeiture defence that s/he took "all reasonable steps to prevent the further use of the property concerned as an instrumentality of an offence…"[1322]

It begs the question as to what is meant by 'all reasonable steps'?. One sensible thing perhaps may be, for the rented property owner, to inform the police of his suspicion or knowledge. However, what if the

[1321] *National Director of Public Prosecutions v 37 Gillespie Street Durban (Pty) Ltd and Another; National Director of Public Prosecutions v R O Cook Properties (Pty) Ltd* and*; National Director of Public Prosecutions v Seevnarayan* par 26.
[1322] See POCA, section 52 (3) (b)

property owner believes that it is also reasonable to confront the tenants as well and tell them to desist from their activities as the neighbours are complaining about it? Would that not be reasonable in the circumstances? The short answer is that it may well be reasonable for a landlord to confront his tenants if there are problems regarding the leased property. However, confronting the tenants in such serious matters as drugs may put his/her life and the neighbour's lives in danger. It is important to consider that offences relating to 'instrumentality' and terrorism as provided for in POCA are not petty, but rather serious, with elements of violence in some instances.

The law itself is meant to prevent organized crime and terrorism financing—not minor misdemeanours. This is quite different from dealing with tenants who sometimes play their radios loudly, causing a nuisance to immediate neighbours. However Mpati DP and Cameron JA argue that POCA is legitimate in requiring property owners to play an active role over their property. They state, at par 29, that they agree that 'the Act requires property owners to exercise responsibility for their property and to account for their stewardship of it in relation to its possible criminal utilization'. Perhaps it is fair to quote the judges at length so as understand their reasoning with regards to this 'stewardship'. They write, at par 28, that

> "We agree that property owners cannot be supine. In particular, we endorse the notion that the State is constitutionally permitted to use forfeiture, in addition to criminal law, to induce members of the public to act vigilantly in relation to goods they own or possess so as to inhibit crime. In a constitutional state law-abiding property owners and possessors must, where reasonably possible, take steps to discourage criminal conduct [while refraining] from implicating themselves or their possessions in its ambit. And the State is entitled to use criminal sanctions and civil forfeitures to encourage this. Here constitutional principle recognizes individual moral agency and encourages citizens to embrace the responsibility that flows with it."

The intentions of this stewardship and the active role that property owners are supposed play may, no doubt, be well intended, i.e. to assist in combating crime. However the lack of guidelines as to what acting 'vigilantly' or taking 'reasonable steps to prevent property from being used to commit crime' mean precisely presents some complications for the general public as in the case of the property owner above. This acting vigilantly may also provide further complications in cosmopolitan societies. Take for instance a property owner who rents out property aware of the provisions of POCA. S/he may be aware that his/her property may be forfeit if s/he rents it out to people who would use it for criminal purposes. This may mean that s/he has to take extra-ordinary measures to vet his/her prospective tenants and, even so, may incur an unsupportable level of risk.

This may not only mean checking his/her prospective tenants for affordability, but also for such things as criminal records. This could end up leading to various forms of discrimination. For instance some property owners may choose to discriminate against rehabilitated people with criminal records. They may choose to discriminate against certain groups that their society has stigmatized or stereotyped, correctly or not. For instance, in Britain, generally, Muslims and people of Asian and Arabic origin seem to be stigmatized as potential terrorists based on the way they look or based on their religious leanings. Would the property owner be reasonable in discriminating against these groups of people as tenants out of fear that they might be terrorists and, therefore, might expose him to forfeiture of his property? Would the property owner who fails to act thus be less than vigilant and fail to exercise their stewardship role, as the Judges argue above?

Another scenario could be that the rented property owner comes across ‘reasonable suspicions’ that his tenants are involved in crime, i.e. storing and selling drugs in his property. Without any proof, but a reasonable suspicion after being informed by neighbours, of such allegations, s/he orders his or her tenants to vacate the property concerned. S/he may reasonably not want to be associated with or be exposed to any possible forfeiture in the future. Would s/he be ‘reasonable’ in ordering his/her tenants to vacate the premises without clear evidence of wrongdoing? What if such suspicions were unfounded? What if the claims were motivated by a grievance on the neighbour’s part so that the evidence is false or wrong? What skills or even guidance could have been given to this landlord in order to evaluate these suspicions? The rented property owner would most probably not have been trained to do this, but is expected to, as POCA places a stewardship role on him/her, to take reasonable steps.

POCA and the Honourable Judges (Mpati DP and Cameron JA) seem to consider this concept of reasonableness rather vaguely and without delineating it. Such vagueness may lead ‘vigilant’ property owners, as members of the public, to interpret the standard of reasonableness very subjectively and then act accordingly. The actions these property owners could take may not be as reasonable as the courts might expect but, in the absence of any guidelines, the property owner may argue that s/he acted 'reasonably' in all these scenarios presented above. Are the POCA requirement of 'stewardship' and an 'active role' of property owners fair in these scenarios, especially for people who may be exposed to forfeiture of their property? POCA may have good intentions, but it is important that the regulatory roles prescribed for the members of the public are more clearly defined, fair and do not expose them and their neighbours to significant dangers. This is not to argue that the public should be passive or supine with respect to combating crime. But where the law expects them to be active it must be clear and not expose them to harm or demand the impossible. .

Interpreting 'proceeds of unlawful activities'

It is important to reiterate that, in terms of Chapter 6, the proceedings are against the property, not '*in personum'*. As a result of this, when the NDPP applies for forfeiture, s/he must apply against a specific property which is either an instrumentality of a crime or the proceeds of crime. This is different from the POCA Chapter 5 criminal proceedings where the NDPP applies for confiscation and can execute against any realizable property to satisfy a confiscation order. In Chapter 5, if the offender's benefit from a robbery (and related criminal activities) that s/he has been convicted of is one million Rands, the state can execute against his/her house, money in the bank, shares in a company, an 'affected gift(s)' or any other interests that can be linked to him/her. The purpose of executing against any property of a convicted criminal may have been 'to avoid the difficulty of tracing particular assets which may have been the proceeds of [a] crime and so to facilitate the recovery of the value of the proceeds'[1323].

However in Chapter 6 *in rem* proceedings, the authorities have to execute against a specific property that is alleged to be the proceeds of unlawful activities. Particular assets that are most probably the proceeds of crime must be forfeit, not simply any property of commensurate value linked to the respondent. However, the wide-net cast by the definition of proceeds of unlawful activity offers a lot of room to manoeuvre for the authorities. To reiterate, POCA defines the 'proceeds of unlawful activities' as

> "…any property or any service advantage, benefit or reward which was derived, received or retained, directly or indirectly, in the Republic or elsewhere, at any time before or after

[1323] See par 24 of *S v Shaik and Others*

> the commencement of this Act, in connection with or as a result of any unlawful activity carried on by any person, and includes any property representing property so derived[1324]".

In his survey of forfeiture legislation in many countries, Anthony Kennedy noted that South Africa had the broadest definition of 'proceeds of unlawful activities' compared to any of the jurisdictions he surveyed[1325]. It appears that in South Africa, just about anything could be proceeds of crime. The purpose of this broad cast of the definition is that "sophisticated criminals will seek to avoid proceeds being confiscated by creating complex systems of "camouflage"[1326]. Reagan ADCJ, in the Shaik judgment, highlights how the definition of proceeds of unlawful activities makes it clear 'that proceeds of crime will constitute proceeds even if "indirectly obtained"'[1327]. The definition speaks of "…any property…derived, received or retained, directly or indirectly". This, for instance, could mean that, if someone bought a house with money earned through selling drugs, the money concerned would represent direct proceeds and the house bought with it could be indirect proceeds.

Let us say that two years after the house was bought, it had doubled in value. What does this added value to the property represent? It may again represent still more 'indirect' proceeds. However, the definition goes even farther to mention property that was unlawfully derived as including "any property representing property so derived". Let us further assume that this house was rented out, earning the owner of the property more money and that the NDPP can prove that the tenants deposited such moneys in a particular bank account belonging to the owner of the property, perhaps in the form of rent. Would such rental amounts also represent 'proceeds of unlawful activity' in terms of this wide definition? This is unclear, but the answer could most probably be in the affirmative; such rental amounts may represent proceeds or "property representing property ",so unlawfully derived. Reagan ADCJ, in the Shaik case, wrote that,

> "…a person who has benefited through the enrichment of a company as a result of a crime in which that person has an interest will have indirectly benefited from that crime…when a shareholder

[1324] See POCA
[1325] See Kennedy, A. 2006. Designing a civil forfeiture system: an issues list for policymakers and legislators. *Journal of Financial Crime,* Vol. 13(2), 132-1632006).
[1326] See par 25 of S v Shaik and Others (CCT 86/07) [2008] ZACC 7; 2008 (5) SA 354 (CC) (29 May 2008).
[1327] *Ibid.* par 26.

commits a crime by which his or her company is enriched, the shareholder may well benefit from the crime in two ways. The value of his or her shares will increase, as will the dividends generated by those shares, because the company is now more profitable[1328]."

From the reading of the above passage, it could be inferred that, in the example of rental earnings from the proceeds of a house bought with drug money above, the property owner will have benefited from the property representing proceeds of unlawful activity. However tracing property so directly or indirectly linked to proceeds of crime in Chapter 6 proceedings may prove very daunting for the authorities, especially where no one is convicted of any offence. However, it is important to mention that Chapter 6 proceedings can be set in motion even in instances where the owner of property had been charged with a criminal offence but was not convicted due to the lack of evidence 'beyond reasonable doubt', as expected in criminal proceedings.

POCA further defines property as "money or any other movable, immovable, corporeal or incorporeal thing and includes any rights, privileges, claims and securities and any interest therein and all proceeds thereof". This definition would literally suggest that anything that represents proceeds of crime can be forfeit in terms of POCA. It does not limit itself to the Schedule 1 predicate offences of POCA. Judges support the view that POCA confiscation and forfeiture provisions do not only apply to organized crime offences only[1329]. This has been found in *NDPP v Van Staden*[1330] where Nugent JA of the Supreme Court of Appeal said:

> "It has been said, at times, that the purpose of the Prevention of Organised Crime Act 121 of 1998 is to combat the special evils that are associated with organised crime, but that is not entirely correct. That is certainly one of its purposes, and perhaps even its principal purpose…its provisions are designed to reach far beyond organised crime and apply to cases of individual wrongdoing[1331]".

[1328] *Ibid.* par 26.
[1329]See National Director of Public Prosecutions v Van Staden and Others (531/05) [2006] ZASCA 107; [2006] SCA 135 (RSA) (9 November 2006).
[1330] *Ibid.*
[1331] *Ibid.* par 1

In this case, the Supreme Court of Appeal had to decide whether a vehicle driven on a public road while under the influence of alcohol was an instrumentality of an offence and could therefore be forfeit or not. This case showed the manner in which the authorities are willing to stretch and over-interpret the laws that were intended to deal with organised crime to achieve other ends. This stretching and over-interpretation still remains to be tested.

Another important definition is that of 'unlawful activities' (see earlier above). Unlawful activities, to reiterate, means 'conduct which constitutes a crime or which contravenes any law' of South Africa. This wide-casting of the meaning of unlawful activities has meant that proceeds of any crime, even if such a crime was not performed in an organized fashion, can be targeted for confiscation and forfeiture under POCA. Like in the instrumentality proceedings, in proceeds of unlawful activities, the NDPP needs to prove on balance of probabilities that if he seeks forfeiture of a car, that particular car is most probably proceeds of unlawful activities or represents property so derived. It is not any car that belongs to the respondent that is seized, but the specific one which is proceeds of crime. This writer is not aware of any case that involved proceeds of unlawful activities under Chapter 6 of POCA. Chapter 6 has tended mainly to be used on instrumentality cases. There is however a recent British case concerning proceeds of crime based on the equivalent legislation to South Africa POCA Chapter 6.

This case involved South Africa's fourth richest citizen, Dr. Christo Wiese, the chief executive of Shoprite Supermarkets. He allegedly travelled from South Africa with over GBP 674,920 (about ZAR7, million), which were found in his luggage by the UK Border Agency at the London City Airport. This money was seized and preserved by the UK Border Agency on suspicion that it was proceeds of crime[1332]. Wiese was reportedly travelling via London to Luxembourg to invest this money which he had smuggled out of South Africa as traveller's cheques and in violation of South Africa's foreign exchange controls[1333]. It is reported that he did not defend the preservation and forfeiture orders and the Westminster Magistrates' Court issued a forfeiture order.

[1332] Moneyweb 2010 "Christo Wiese's R7m travelers cheques mystery", Lindo Xulu, Moneyweb Holdings Limited, 05 December 2010. Retrieved from: http://www.moneyweb.co.za/mw/view/mw/en/page295046?oid=519664&sn=2009+Detail&pid=287226

[1333] *Ibid.*

Appendix 4.3: A brief comparative discussion of FICA business regulations

Since there is lack of jurisprudence on regulations against money laundering in South African law we draw on jurisprudence regarding similar provisions in other countries, particularly the UK, in order to enrich our understanding of these provisions and the practical implementation dilemmas they pose for the regulated businesses and persons. There are five key broad regulatory obligations that FICA and the Counter-Money Laundering Regulations place on regulated businesses, or the so called 'accountable institutions', in FICA. To some extent they parallel the duties of the FIC mentioned earlier. These duties, discussed in some length below, are: 1. a duty to identify clients, 2. a duty to keep records, 3. a duty to report various types of customer transactions to the Financial Intelligence Centre, 4. a duty to establish internal compliance systems which include the training of staff and 5. a duty to appoint compliance officers. All these duties are aimed at ensuring that regulated businesses and professionals assist law enforcement initiatives to combat crime. This they will do through knowing who their customers really are, making records available to law enforcement agencies in case there are investigations later on, and monitoring the transactions of their clients and reporting those who they view as suspicious, unusual or prescribed (i.e. above set threshold amounts).

Failure to comply with these duties is backed by a range of sanctions, from fines to custodial criminal sentences. The institutions and persons regulated by FICA and its regulations are referred to as 'accountable institutions'. These institutions and persons include banks, insurance brokers and agents, attorneys, auditors, real estate agents, financial instruments traders and a host of other persons and private institutions[1334].

[1334] See *Ibid.* The list of accountable institutions as contained in Schedule 1 is as follows: 1. An attorney as defined in the Attorneys Act, 1979 (Act 53 of 1979), 2. A board of executors or a trust company or any other person that invests, keeps in safe custody, controls or administers trust property within the meaning of the Trust Property Control Act, 1988 (Act 57 of 1988), 3. An estate agent as defined in the Estate Agents Act, 1976 (Act 112 of 1976), 4. A financial instrument trader as defined in the Financial Markets Control Act, 1989 (Act 55 of 1989), 5. A management company registered in terms of the Unit Trusts Control Act, 1981 (Act 54 of 1981), 6. A person who carries on the 'business of a bank' as defined in the Banks Act, 1990 (Act 94 of 1990), 7. A mutual bank as defined in the Mutual Banks Act, 1993 (Act 124 of 1993), 8. A person who carries on a 'long-term insurance business' as defined in the Long-Term Insurance Act, 1998 (Act 52 of 1998), including an insurance broker and an agent of an insurer, 9. A person who carries on a business in respect of which a gambling licence is required to be issued by a provincial licensing authority, 10. A person who carries on the business of dealing in foreign exchange, 11. A person who carries on the business of lending money against the security of securities, 12. A person who carries on the business of rendering investment advice or investment broking services, including a public accountant as defined in the Public Accountants and Auditors

We now turn to the duties placed on these institutions and persons. Below we interchangeably use the term 'accountable institutions' and 'regulated businesses'. In this usage we include both institutions and persons that are regulated. We refer to them as 'regulated businesses' to denote the fact that they were/are regulated as a result of the business or professional services that they provide to the general marketplace. However, it is important to clarify that there are other businesses that come before the regulatory prescriptions of FICA but less so as compared to 'accountable institutions'. These others are referred to in FICA as 'reporting institutions that are only regulated to identify their customers and to report suspicious and related transactions to FIC. They are therefore not expected to appoint compliance officers or keep records for extended periods of time and so on, as are "accountable institutions".

FICA: Duty to Identify Clients

In Part 1, FICA prohibits regulated businesses from establishing a business relationship or even concluding a single transaction with a client that it has not properly identified[1335]. If that client acts for somebody else, that somebody else must also be properly identified as is prescribed in the Counter-Money Laundering Regulations[1336]. The Counter-Money Laundering Regulations (or the regulations) give detailed guidelines on how regulated businesses should identify and verify the identity of their customers. The regulations specify how the identity of natural and resident foreign nationals, local and foreign companies, partnerships and trusts should be identified and verified[1337].

Among these are requirements for identity documents, income tax registration certificates, residential addresses (as opposed to postal) and contact details. While these requirements may seem

Act, 1991 (Act 80 of 1991), who carries on such a business, 13. A person who issues, sells or redeems travellers' cheques, money orders or similar instruments, 14. The Postbank referred to in section 51 of the Postal Services Act, 1998 (Act 124 of 1998), 15. A member of a stock exchange licensed under the Stock Exchanges Control Act, 1985 (Act 1 of 1985), 16. The Ithala Development Finance Corporation Limited, 17. A person who has been approved or who falls within a category of persons approved by the Registrar of Stock Exchanges in terms of section 4 (1) (a) of the Stock Exchanges Control Act, 1985 (Act 1 of 1985), 18. A person who has been approved or who falls within a category of persons approved by the Registrar of Financial Markets in terms of section 5 (1) (a) of the Financial Markets Control Act, 1989 (Act 55 of 1989), 19. A person who carries on the business of a money remitter.

[1335] *Ibid.* s. 21 (1) (a) and (b).

[1336] *Ibid.* s 21 (2) (a) to (d).

[1337] See Regulations in terms of the *Financial Intelligence Centre Act, 2001, No. R. 1595*.

modest, some of them are more difficult to supply for people living in informal settlements with no unique and verifiable residential address. This has presented a number of challenges for regulated businesses their customers and government as many South Africans live in informal settlements and have no proof of address (see more on this in Chapter 6).

However, as was seen when the implementation of the AML regulations was discussed in Chapter 6, the authorities have promulgated some exemptions to try and accommodate clients without the required documentation. However, AML customer identification and verification requirements, in the early years of implementation of FICA, meant that if identities and addresses of clients could not be verified, no bank account could be opened in case of banking institutions. While the intention of the FICA was to detect and combat organized crime, it became clear that it could have undesired consequences of financial exclusion for a large number of citizens in the country.

One of the questions for this research therefore has been whether FICA laws and regulations have had to be bent, in South Africa, in order to accommodate clients that cannot provide some types of documents for verification. If they have been bent, to what extent? If not, why? A further question is what implications any of these answers have for South Africa's compliance with the global anti-money laundering regime of the FATF. And, lastly, what implications do these answers have for economic growth and social integration in South Africa? t What exactly did the FICA and its regulations provid for when it was enacted.

FICA: Duty to Keep Records

Part 2 of FICA set out requirements for regulated businesses to keep various forms of client records for extended periods of time[1338]. These are records relating to identity and addresses of customers and transactions that clients conduct with them. The regulations specify the period for the keeping of such

[1338] *Ibid.* Section 22. See also Regulations in terms of the Financial Intelligence Centre Act, 2001, No. R. 1595.

transaction records, which is five years after a transaction was concluded. They should keep these records (for five years) even after the businesses relationship has been terminated[1339].

In section 24, FICA allows regulated businesses to keep these sensitive records of personal data with third parties. It also allows these records to be kept in an electronic format. This may solve some of the logistical data storage nightmares that might arise were institutions only allowed to keep these records as hard copies. This would be much more of a burden, even in electronic form, for institutions which have millions of customers such as banks and insurance companies. In terms of costs, this duty to keep records does present regulated businesses with some overheads and a number of logistical and risk management challenges. Even where records are kept with third parties, FICA does not absolve regulated businesses of their obligations should such information get lost or corrupted in any way[1340]. FICA requires these institutions to give access to a FIC employee who may be allowed access to the data where FIC requires additional information relating to reports made by the businesses to the Centre or through the production of a court warrant.

FICA: Unusual, suspicious, cross-border and threshold transaction reports

The South African regime for reporting money laundering transactions and financing of terrorism activities requires the regulated businesses to report four types of transactions. These are unusual, suspicious, electronic and cash cross-border, and cash transactions. They report these transactions to the Financial Intelligence Centre, based in Pretoria, Tshwane. With regards to cash, electronic and cross-border transaction reports, the regulated businesses are expected to report any transaction conducted through or with them by their clients exceeding a prescribed amount set by FIC. The reporting of threshold transactions only started in late 2010. The reporting of cash and electronic cross-border transactions is reported to the exchange control division of the South African Reserve Bank (SARB) as it coincides with the exchange control regulations of the Reserve Bank.

[1339] *Ibid.* Section 23. See also Regulations in terms of the Financial Intelligence Centre Act, 2001, No. R. 1595.
[1340] FICA Section 24.

SARB is then supposed to send these cross-border reports to FIC. Both unusual and suspicious transaction reporting tend to be problematic since there is no definition of what these transactions mean. The reporting of these transactions relies on internal policies of each of the regulated businesses and the extent to which they have trained their staff. This is because these transactions are not defined either in FICA or the attendant regulations (the AMLCRs). This leaves all these types of institutions with discretion and a legal defence. The defence is that they may argue that they did not report a transaction because it was not unusual or suspicious to them.

After reporting a transaction, FIC can direct the reporting business not to proceed with such a transaction[1341]. This happens in the event where FIC suspects that there are suspicions or money laundering taking place and wants law enforcement agencies to investigate further[1342]. This intervention by the FIC can only stop the regulated business from undertaking such a transaction for only five working days[1343]. This allows, for instance, the Asset Forfeiture Unit to bring a preservation or restraint order FIC and investigating agencies can determine if such transaction or funds involved do constitute the proceeds of crime or not. This also allows them the necessary time to apply for court orders to freeze such funds.

In terms of section 35 of the Act, the Centre can also initiate the reporting of all transactions in relation to a particular account or entities or persons, when it suspects money laundering or is requested by a law enforcement agency for such monitoring. This is done through what is referred to as 'monitoring orders'. These are issued by a judge on application by the Centre. These monitoring orders are valid for a period of three months, and are extendable (on further application) for further periods of three months as long as the reasons they were issued for still exist[1344]. In practice these provisions allow law enforcement

[1341] *Ibid.* Section 34 (1).
[1342] See further discussion of this in *Chapter 7.*
[1343] See FICA, Section 34 (2).
[1344] Monitoring orders are issued by a judge who is designated by the Minister of Justice for the purposes of the *Interception and Monitoring Prohibition Act, Act No. 72 of 1992*. The judge may issue these orders (see Section 35 of FICA) if there are reasonable grounds to suspect that:

> (a) that person has transferred or may transfer the proceeds of unlawful activities or property which is connected to an offence relating to the financing of terrorist and related activities to the accountable institution or is using or may use the accountable institution for money laundering purposes or for the financing of terrorist acts or for the purpose of any transaction contemplated in section 29 (1) (b); or
> (b) that account or other facility has received or may receive the proceeds of unlawful activities or property which is connected to an offence relating to the financing of terrorist and related activities or is being or may be used for money laundering purposes or for the financing of terrorist or related activities or for the purpose of any transaction contemplated in section 29 (1) (b).

agencies to request the Centre to apply for such monitoring of accounts or facilities on their behalf. This happens mainly in cases that these investigating agencies are already probing.

It is not only the regulated businesses that are obliged to report. In FICA and the related regulations, there are other businesses that are required to report the types of transactions mentioned above, although they are not required to perform all the regulatory functions. They are referred to as "reporting institutions" and include casinos, vehicles dealers, and dealers in high value goods as listed in Schedule 2 of FICA.

Further, the reporting duties are, to an extent, also extended to supervisory bodies and the South African Receiver of Revenue (SARS). The supervisory bodies and SARS 'must' advise and supply the Centre with all information and records regarding any knowledge or suspicion they may have relating to the usage of a regulated business for money laundering and terrorism financing purposes[1345]. The Centre may also proactively request assistance from the supervisory bodies and SARS if it believes that they may have information about the usage of 'accountable institutions' for the perpetuation of money laundering and terrorism financing[1346].

One of the most controversial provisions of FICA relates to issues of confidentiality and secrecy between the regulated businesses and their clients. FICA provides that 'no duty of secrecy or confidentiality or any other restriction on the disclosure of information, whether imposed by legislation or arising from the common law or agreement, affects compliance by any accountable institution, supervisory body, reporting institution, the South African Receiver of Revenue or any other person with provisions of reporting' contained in Chapter 4 of the Act. However, these confidentiality provisions, to an extent, absolve the legal profession. The exemption applies to the common law right to legal professional privilege between an attorney and a client in respect to communications made in confidence between

a) the attorney and the attorney's client for the purposes of legal advice or litigation which is pending or contemplated or which has commenced; or

b) a third party and an attorney for the purposes of litigation which is pending or

[1345] *Ibid.* Section. 36
[1346] *Ibid.*

contemplated or has commenced.

The issue of confidentiality has elicited a lot of debate among regulators and regulated businesses and various authors have written about it in various jurisdictions. The complaints have been that regulated businesses are being asked to violate one of their historical and contractual relationships with their clients; that of client confidentiality or privilege.

It is claimed that this client-confidentiality doctrine is very strongly guarded within the banking, legal and accounting professions. While the legal profession is required to report transactions, such legal professional privilege cannot be claimed, for instance, where lawyers act as intermediaries in a financial transaction on behalf of their client. In relation to banking, the legal position, particularly in the UK, has been that lawyer-client confidentiality is not absolute but qualified by four exceptions. This is where a disclosure is; mandated by law, demanded by public duty, in the best interest of the bank, or made with the express or tacit permission of a client[1347]. Although these exceptions were developed in an English case in 1924, South African judges, according Van Jaarveld, have normally used these exceptions in taking decision pertaining to bank-client confidentiality[1348]. However, there has been no court case that has looked into these matters directly from the standpoint of the responsibilities imposed by FICA and its regulations.

The information which may be held by the Centre could be very confidential as it relates to people's transactions and other personal data. FICA, therefore, provides for a number of safeguards in relation to this information. For instance regulated businesses making reports to the Centre are protected from any liability as a result of the reports they make to the FIC[1349]. Should the information they supply end up being used in court in a prosecution, they are not obliged to give evidence[1350]. The mere production of a statement from the Centre, certifying the source of information, is admissible in court[1351]. There are also other

[1347] See Van Jaarsveld, I. 2001. The end of bank secrecy? Some thoughts on the Financial Intelligence Centre Bill. *South African Mercantile Law Journal*. These exceptions were developed from the *Tornier* case in England. See *Tournier v National Provicial & Union Bank of England* (1 KB 461) 1924).
[1348] See Van Jaarsveld, I. 2001. The end of bank secrecy? Some thoughts on the Financial Intelligence Centre Bill. *South African Mercantile Law Journal*.
[1349] *Ibid.* Section 38.
[1350] *Ibid.* Section 39.
[1351] *Ibid.*

safeguards built into FICA regarding access to information held by the Centre[1352] and protection of confidential information[1353].

FICA: Duty to develop and implement compliance measures and train staff.

The accountable institutions are required by FICA to develop, compile and implement internal rules regarding the identification and verification of their customers, the manner in which records should be kept, the guidelines relating to identification and reporting of transactions and steps to be taken for such reporting by their employees to the FIC[1354]. A copy of these internal rules, must, on request by the FIC or a supervisory body, be supplied[1355]. It is also a legal requirement for regulated businesses to train their employees with regards to their duties and internal rules[1356]. They are also required to appoint a compliance officer whose responsibility is to ensure that these businesses comply with the provisions of FICA[1357].

1352 *Ibid.* Secion 40.
1353 *Ibid.* Section 41.
1354 *Ibid.* Section 42.
1355 *Ibid,* Sections 42 (4) (a) & (b)
1356 *Ibid.* Section 43 (a)
1357 *Ibid.* Section 43 (b)

Appendix 6.1: A short history of South Africa's banking sector[1358]

The South African banking sector under colonial-apartheid dispensations

The FATF standards of AML/CTF were implemented within a banking sector beset by enormous problems of inefficiency and ineffectiveness. It is our view that implemented in such a sector the KYC/CDD requirement could further exacerbate these politically charged problems. It is important to give a brief history of this sector in South Africa spanning from early colonial to apartheid and to the transitional era in order to fully appreciate the issues of exclusion and competition which greatly affected the extension of banking services to the poor.

In his speech to the end of year media gala dinner in 2004, the then Governor of the South African Reserve Bank, Tito Mboweni remarked that

> "South Africa has established a well-developed banking system which compares favourably with those in many developed countries and which sets South Africa apart from many other emerging market countries…we find ourselves with a more mature banking sector , with a moderate level of private sector indebtedness and a reputable and first rate regulatory and legal framework"[1359].

In support of this statement, Mboweni cited, among others, South Africa's regulatory and risk management practices which complied with 'international best practices' of the Basel Committee on Banking Supervision (BCBS) and the nation-wide access of customers to their bank accounts "24 hours a day, every day of the year"[1360]. He also referred to South Africa's liberalisation which had reintegrated the new democracy into the global economy. South Africa, as a country, and its economy -- including its banks, had suffered some isolation during the apartheid regime's reign. This was due to UN sanctions imposed on South Africa in the world-wide protest against apartheid. These sanctions were lifted in the early 1990s when the country established a democratic government.

This changing political environment and post-apartheid government policies provided an enabling environment for South African-controlled banks to establish a presence and operations abroad. International

[1358] Read with Chapter 6.
[1359] Tito Mboweni, *Address to the End of Year Press Gala Dinner*, 14 December 2004, Pretoria.
[1360] *Ibid.*

banks were also increasingly establishing operations in South Africa -- some for the first time and others returning after pulling out in the 1980s following, mainly, international anti-apartheid campaigns and sanctions. With liberalisation and the gradual easing of foreign exchange controls, South Africa, according to Mboweni, was now also open to the occasional shocks taking place in the global financial system[1361]. This means that when there is turmoil in other parts of the world, as happened in 1998, with the East-Asian crisis and, recently, with what has become known as the 'global financial crisis', the South African economy as whole somehow has to absorb such shocks.

In 2007, when the global financial crisis started in the US and spread throughout the Western world, the impact was, in some instances, directly felt by the developing market economies. With failure of banks in a number of developed countries which had to be saved by governments from collapse, South African banks did not escape the upheaval untouched. Some South African banks were reported to have been exposed to toxic debt through their operations abroad. Some took a hit and faced slumping profits. These banks were consistently looking for ways to clean their balance sheets amid rising global campaigns by governments to reform banking regulation.

Although no South African bank needed a government bailout or collapsed, some have had to cautiously review and streamline their operations, amidst the prevailing uncertainty. Below we look at South Africa's banking sector with the aim of examining the environment under which the FATF's financial regulatory regime was implemented when FICA was passed in 2001. A bank is "a financial institution whose main activities are borrowing and lending money"[1362]. Banks borrow money by accepting deposits and lending that money out to individuals, firms and governments[1363]. Within this definition, there are two main categories[1364] of banking activity: 'commercial banking' and 'investment banking'. Nowadays, many

[1361] *Ibid.*
[1362] Black, J. et al. 2009. *The Oxford Dictionary of Economics*. Oxford University Press, Clarendon, 3rd Edition, p.25.
[1363] *Ibid.*
[1364] Both these forms of banking activity are regulated by the AML laws in South Africa, as in many other countries observing similar laws. While at a global level, the regulation of banks against money laundering as propounded by the FATF was, initially, mainly focussed on commercial banking activity rather than on investment banking, later developments have also focussed on investment banking; seeking to bring this elite sector under regulation. For instance, while the European Union's (EU) First and Second Directives against money laundering seem to have been designed for commercial banking activities; the Third Directive has brought investment banking and capital markets more into the fold. With respect to the implementation of the AML laws and regulations in South Africa, my focus is on commercial banking activity as this directly affects individuals and households in direct ways more than wholesale banking activity.

banking groups, or holding companies of banks, are comprised of subsidiaries engaged in both these functions and more activities[1365].

A commercial bank offers services to the general public, 'accepting deposits and making loans to large numbers of households and small firms'[1366]. Commercial banks are variably referred to as retail or high street banks. They also provide various services for depositors such as transaction facilities, credit cards, foreign exchange, mortgage and car finance[1367]. Investment banks, on the other hand, provide services to large firms, rather than the general public, providing such specialist services as 'financing foreign trade by accepting bills of exchange; providing hire purchase and industrial finance; underwriting new issues; advising on and arranging finance for mergers and takeover bids; and managing investment for institutions and wealthy individuals.'[1368] Investment banking is also invariably referred to as merchant or wholesale banking. There can however be no neat categorisation as most banks nowadays seamlessly engage in both these functions and more through their subsidiaries[1369].

For legal and regulatory purposes, the South African Banks Act of 1990 classified banks according to their registration and reporting regulatory requirements. The Office of Banks headed by the Registrar of Banks, is given powers by the Banks Act to register, supervise and regulate all institutions involved in a 'business of a bank'[1370]. According to these categories, there are locally registered/incorporated banks, mutual banks, branches of foreign banks and representative offices of foreign banks. They have different prudential regulatory requirements.

Different categories of banks in South Africa

By locally incorporated banks is meant South African owned banks (local banks) and subsidiaries of foreign banks which are controlled by locally registered public companies in terms of the *South African Companies Act of 1973 (Act No 61 of 1973)*[1371]. Mutual Banks are banks incorporated under the *Mutual*

[1365] See Ellinger, E.P., et al. (2002). *Ellinger's Modern Banking Law*. Oxford University Press, 4th Edition, p.1-25.
[1366] Black, J. et al. 2009. *The Oxford Dictionary of Economics*. Oxford University Press, Clarendon, 3rd Edition, p.69.
[1367] *Ibid.*
[1368] *Ibid.* p.289
[1369] See Ellinger, E.P., et al. (2002). *Ellinger's Modern Banking Law*. Oxford University Press, 4th Edition, p.1-25.
[1370] See *Banks Act of 1990*, (Act No. 94 of 1990), South Africa
[1371]See Regulation Gazette No. 8815 01 January 2008.

Banks Act, *Act 124 of 1993.* They are the equivalent of building societies in jurisdictions such as England. They are required to maintain minimum capital and reserve funds as contemplated in the *Regulations relating to Mutual Banks* issued by the Minister of Finance of South Africa under Section 91 of the *Banks Act, Act 94 of 1990*[1372].

Branches of foreign banks are regulated by the *Conditions for the conducting of the business of a bank by a foreign institution by means of a branch in the republic* issued by the Minister of Finance of South Africa under Section 90 of the *Banks Act 1990*. They operate as deposit-taking and lending institutions and are therefore required to, among other things; register with the Registrar of Banks, obtain and pay annual banking license fees, meet specified prudential capital and liquidity requirements and submit annual financial statements to Registrar of Banks[1373]. The last category is the representative offices of foreign banks.

The representative offices of foreign banks are offices engaged in secondary banking activities for banks incorporated in foreign jurisdictions. For instance Santander Bank may choose not to open a branch or a subsidiary in South Africa, but a recognised and registered representative office, with the purpose of engaging in investment activities. These offices are regulated by the *Regulations relating to representative offices of foreign banking institutions*[1374]. These regulations require them to register with the Registrar of Banks. Representative Offices are however not permitted to accept deposits from the public but allowed to engage on such activities as: advisory services to their network customers, asset securitisation and principal finance, asset management, corporate finance, correspondent banking, project finance, structured finance, syndicated lending, trade and export finance, property finance, among others[1375]. They are required to submit annual reports to the Registrar of Banks on their operations in South Africa[1376]. They are also required to submit a copy of financial statements of their parent banks to the Registrar. Lastly, they have to inform the Registrar of Banks of any material changes in their legal status in other foreign jurisdictions.

http://www.reservebank.co.za/internet/Publication.nsf/LADV/

[1372] See Regulation Gazette No. 7181 05 October 2001 http://www.reservebank.co.za/internet/Publication.nsf/LADV/

[1373] See Regulation Gazette No. 8814 1 January 2008. http://www.reservebank.co.za/internet/Publication.nsf/

[1374] See Regulation Gazettee No 7227 13 December 2001. http://www.reservebank.co.za/internet/Publication.nsf/

[1375] *Ibid*.

[1376] *Ibid*.

The main difference between these types of banks is the level of their operations and the manner in which they are regulated. Locally incorporated banks are fully regulated by the authorities as they pose more systemic risk than, for instance, the representative offices. The latter are not permitted to take deposits and, as a result, do not pose any liquidity or systemic risk. A one-branch small operation of a foreign bank would pose a lesser systemic risk than, for instance, a subsidiary of a foreign bank with extensive operations. The latter are locally publicly listed companies which may have to be rescued by the South African Reserve Bank, as lender of last resort, should they face a liquidity crisis, while branches of foreign banks may have to rely on their parent banks oversees to rescue them. The regulations on locally incorporated banks (which include local banks and subsidiaries of foreign banks) include; the conduct of business, corporate governance and prudential and reporting requirements.[1377]

South Africa has long been dominated by a few major banks: Standard Bank, Absa Bank, First National Bank and Nedbank. That has long been the case. The consolidation of market positions and power by these four banks spans sometimes over different political regimes whose policies constrained the participation and access by large sectors of the population, especially those marginalised by colonial and apartheid policies. Three of these banks trace their history back to the mid-1800s. At the beginning of the 20th Century, three of these banks -- Standard Bank, First National Bank and Nedbank -- were already well established[1378]. ABSA's history is traced to the formation of an Afrikaans bank known as Volkskas Bank in 1942. Banking history in South Africa can be traced back to 1793, when Lombard Bank, the first ever bank in the country, was opened in the Cape[1379]. By 1861, the Cape had no fewer than 29 banks[1380]. The opening of banks in the Cape is linked to farming and the discovery of minerals, especially diamonds, in Griqualand (later renamed Kimberly) around the same period. Goosen *et al* tells us that the year 1861 was noteworthy in the evolution of banking in South Africa. It is the year in which an English company called *The London and South African Bank* opened branches in Port Elizabeth, Durban, Cape Town and

[1377] These include reporting on; balance sheet and off-balance sheet activities; income statements; returns regarding shareholders, investments, loans and advances; credit risk reports (monthly, quarterly and half-yearly); liquidity risk, minimum reserve balances and liquid assets; market risk; daily returns on selected risk exposures arising from trading and treasury activities; interest rate risk; equity risk in their banking books; derivative instruments; operational risks returns; securitisation schemes and related exposures; and capital adequacy, among others.
[1378] Goosen, W., Pampallis, A., Van Der Merwe, A. & Mdluli, L. 1999. *Banking in the New Millenium*, Cape Town: Juta & Co Ltd.
[1379] *Ibid.* p.16.
[1380] *Ibid.*

Grahamstown[1381]. This was followed by the opening of the *Standard Bank of British South Africa Ltd* in Durban and Grahamstown in 1862[1382].

While the latter bank was formed in South Africa, it was incorporated in London. In 1877 these two imperial banks, the *London and South African Bank* and the *Standard Bank of British South Africa*, merged to form what became known as the *Standard Bank of British SA Ltd*[1383]. This commercial bank exists today as *Standard Bank Limited*, a subsidiary of the *Standard Bank Group*. The word "British" in the name of the bank was dropped in 1883. In the early 1960s, the group was partly owned by *Standard Bank Limited of London*, a holding company which later became *Standard & Chartered Bank plc*. In 1987, *Standard & Chartered Bank plc* sold its 39 per cent shares to make the Standard Bank Group a 100 per cent South African owned entity.

The *Standard Bank Group* (SBG) describes itself as a 'global bank with African roots' and it is reportedly South Africa's largest bank of the 'big four' in terms of assets and headline earnings[1384]. By the end of December 2009, the group had total assets of over R1, 345 billion (about US $ 183 billion) and employed over 50 000 people worldwide[1385]. The bank now has operations in 17 African countries[1386] and 16 other countries outside Africa[1387]. In Africa, *Standard Bank* has expanded through acquisitions, providing personal and business banking services, with more than 348 branches and over 770 automated-teller machines (ATMs) outside South Africa[1388]. In other parts of the world, SBG has focussed on corporate and investment banking franchises. However, in countries such as Argentina and Brazil, it provides full personal and business banking services[1389]

[1381] *Ibid.* p.18.
[1382] *Ibid.*
[1383] *Ibid.*
[1384] *Standard Bank Group Annual Report 2009, http://annualreport2009.standardbank.com/*
[1385] *Ibid.*
[1386] *Ibid.* Standards Bank South Africa has an extensive network in Africa with 348 branches and 770 ATMs. It has a presence in the following African countries; Angola, Botswana, Democratic Republic of the Congo, Ghana, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.
[1387] *Ibid.* Outside Africa, Standard Bank South Africa has been in the form of Corporate & Investment Banking franchises, with a presence in Argentina, Brazil, the US, Isle of Man, Jersey, Russian Federation, Turkey, Ukraine, UK, Iran, United Arab Emirates, China (including Hong Kong), Japan, Malaysia, Singapore and Taiwan.
[1388] *Ibid.*
[1389] *Ibid.*

Another old bank, First National Bank, traces its history from the formation of the Eastern Province Bank of Grahamstown in 1838[1390]. The history from then onwards is filled with mergers, acquisitions and several name changes. First National Bank, which started using this name only in 1986, was previously known as Barclays National Bank and largely owned by the Barclays Bank of Britain since 1926[1391]. However, in 1986, Barclays sold its shares to South African shareholders, making it 100 per cent locally owned. Barclays later exited the South African market[1392] due to the anti-apartheid campaigns.

Nedbank's history is traced to 1888 with the formation of the Nederlandsche Bank en Credietvereeniging voor Zuid Africa in Pretoria[1393]. It was renamed in 1902 to Nederlansche Bank voor Zuid Africa and in 1971 as Nedbank[1394]. The Bank is currently owned by Old Mutual and HSBC was recently reported to be making a bid to acquire up to 77% of its shares -- a purchase which HSBC later abandoned. All the above three banks, Standard Bank, FNB, and Nedbank, were prior to World War II largely English owned. It is reported that the Afrikaner elite was not happy with the English domination of South African banks[1395].

ABSA has its roots in Volkskas. In 1942, a bank known as Volkskas, which became the banker for the *Broederbond*, a secret society of the Afrikaners, and the apartheid government, was formed[1396]. Volkskas merged with a number of other mainly Afrikaner controlled banks such as Bankorp, United Bank to form the Amalgamated Banks of South Africa or ABSA in 1992[1397].

Changing banking composition and market dominance post-apartheid

The statistical information in this part, especially on the number of banks operating in South Africa, is from the *Banking Supervision Division Annual Reports* of 1994 to 2009. In December 2009 there were

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[1390] Goosen, W., Pampallis, A., Van Der Merwe, A. & Mdluli, L. 1999. *Banking in the New Millenium*, Juta & Co Ltd.
[1391] *Ibid.*
[1392] *Ibid.*
[1393] *Ibid.*
[1394] *Ibid.*
[1395] Gidlow, R. 2008. Foreign banks, exchange controls and the future of four pillars bank policy in South Africa. *South Africa Journal of Economic History*, Vol. 23 (1)
[1396] *Ibid.*
[1397] *Ibid.*

33 South African registered banks as compared to 60 in 2000 and 41 in 1994[1398]. Two of these 33 were mutual banks, three in 2000 and two in 1994. Thirteen were branches of international banks[1399]. In 2009, there were 42 authorised representative offices[1400] of foreign banks, compared to 61 in year 2000 and 40 in 1994. There was an almost 50 per cent decrease in the number of registered banks and representative offices between 2000 and 2009, while the number of foreign bank branches and mutual banks remained almost the same[1401].

Between 1994 and 2000, there was a 2 per cent increase in the number of locally incorporated banks and 20 percent increase in the total number of representative offices. The decrease in the number of banks between 2000 and 2009 happened mainly between 2002 (30 registered banks- from 41 in 2001 and 42 in 2000) and 2003 (22 registered banks). During that period a number of smaller to medium banks were squeezed out of the market and some taken over by others. This was mainly due to the liquidity crisis at Saambou Bank, South Africa's 6th largest bank by assets then[1402]. Saambou Bank collapsed, reportedly causing a 'run' on other smaller banks and systemic concerns to regulators and government.

[1398] The 33 South African-registered banks as of December 2009 were: ABSA Bank Limited, African Bank Limited, Albaraka Bank Limited, Capitec Bank Limited, FirstRand Bank Limited, Habib Overseas Bank Limited, HBZ Bank Limited, Imperial Bank Limited, Investec Bank Limited, Marriott Merchant Bank Limited, Mercantile Bank Limited, Nedbank Limited, Peoples Bank Limited, Rennies Bank Limited, Sasfin Bank Limited, Teba Bank Limited, The South African Bank of Athens Limited, The Standard Bank of South Africa Limited, MEEG Bank Limited, GSB Mutual Bank, VBS Mutual Bank, Islamic Bank Limited and Regal Treasury Private Bank Limited.

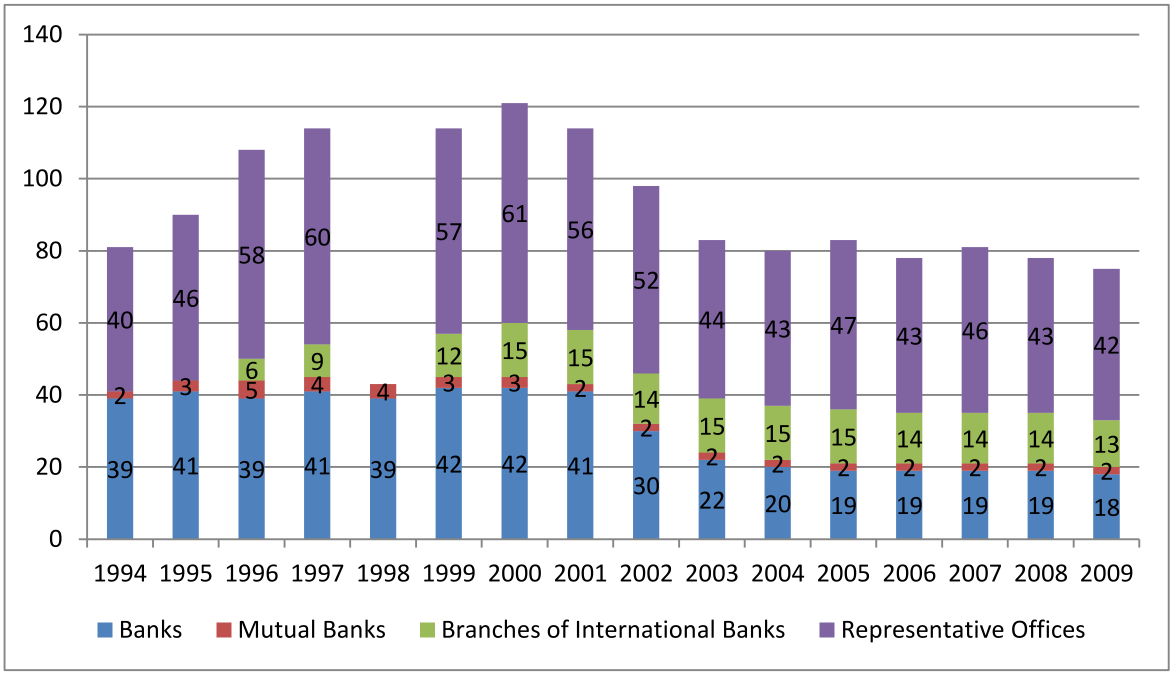
[1399] In December 2009, Branches of international banks were: ABN AMRO Bank N.V., Bank of Baroda, Bank of China Johannesburg Branch, Bank of Taiwan South Africa Branch, Barclays Bank Plc South Africa Branch, Calyon Corporate and Investment Bank, China Construction Bank, Citibank N.A., Commerzbank Aktiengesellschaft, Deutsche Bank AG, HSBC Bank Plc Johannesburg Branch, JPMorgan Chase Bank Johannesburg Branch, Societe Generale, Standard Chartered Bank Johannesburg Branch, State Bank of India.

[1400] In December 2009 Authorised representatives of foreign banks were: American Express Bank Limited, Banca di Roma, Banco BPI SA, Banco Espirito Santo e Comercial de Lisboa, Banco Privado Portugues SA, Banco Totta & Acores SA, Bank Leumi Le-Israel BM, Bank of Cyprus Group, BNP Paribas Johannesburg, Barclays Private Bank Limited, Bayerische Hypo - und Vereinsbank AG, Belgolaise Bank, China Everbight Bank, Commezbank AG, Credit Industriel et Commercial, Credit Suisse (South Africa) (Pty) Limited, Credit Suisse First Boston (Europe) Limited, Dresdner Bank AG, Dresdner Kleinwort Wasserstein Limited, Export-Import Bank of India, First Bank of Nigeria, Fortis Bank (Nederland) N.V., Gerrard Private Bank (Isle of Man) Limited, Gerrad Private Bank (Jersey) Limited, Hellenic Bank Limited, ING Bank (Switzerland) Limited, Kredietbank SA Luxembourgeoise, Laiki Banking Group, Millenium BCP, NM Rothschild & Sons (CI) Limited, Netexis Banques Populaires, National Bank of Egypt, Royal Bank of Canada Europe Limited, Societe General Representative Office for Southern Africa, Sumitomo Mitsui Banking Corporation, The Bank of new York, The Bank of Tokyo-Mitsubishi Limited, Southern and Eastern Africa of the Export-Import Bank of China, The Royal Bank of Scotland, UBS AG, Union Bank of Nigeria, Vnesheconombank, Wachovia Bank- NA, WestLB AG.

[1401] See Figure 6.1.

[1402] Tito Mboweni, *Address to the End of Year Press Gala Dinner*, 14 December 2004, Pretoria.

Figure 6.1: Number of Banks Operating in South Africa: 1994 to 2009



Source: Compiled by Author from the South African Reserve Bank's Banking Supervision Division Annual Reports of 1994 to 2009.

The four largest banks, which are generally referred to as the 'big four', currently control more than 84% of South Africa's total banking sector assets and market[1403]. This means that these banks have generally had the most clients and this shows high levels of 'concentration' in the South African market. Highly-concentrated markets are generally viewed as less competitive, in economic terms. Since 1994, these big four banks have consistently dominated the balance sheet of the total banking assets and market with important implications for access to financial services.

In 1994 they controlled 77% of the market, moderating to 65% in 2000 and consistently re-gaining more control up to 2006 (84%) -- a position they have maintained until December 2009, when the annualised balance sheet data was released by the Banking Supervision Division of the South Africa Reserve Bank. The strength of these banks since the 1994 transition, in terms of banking assets and market share, has only improved[1404]. Many critics argue that the liberalisation of South Africa's economy and

[1403] See *Banking Supervision Division Annual Report 2009*, South African Reserve Bank, Pretoria.
[1404] See Figure 6.2 for summary of banking dominance.

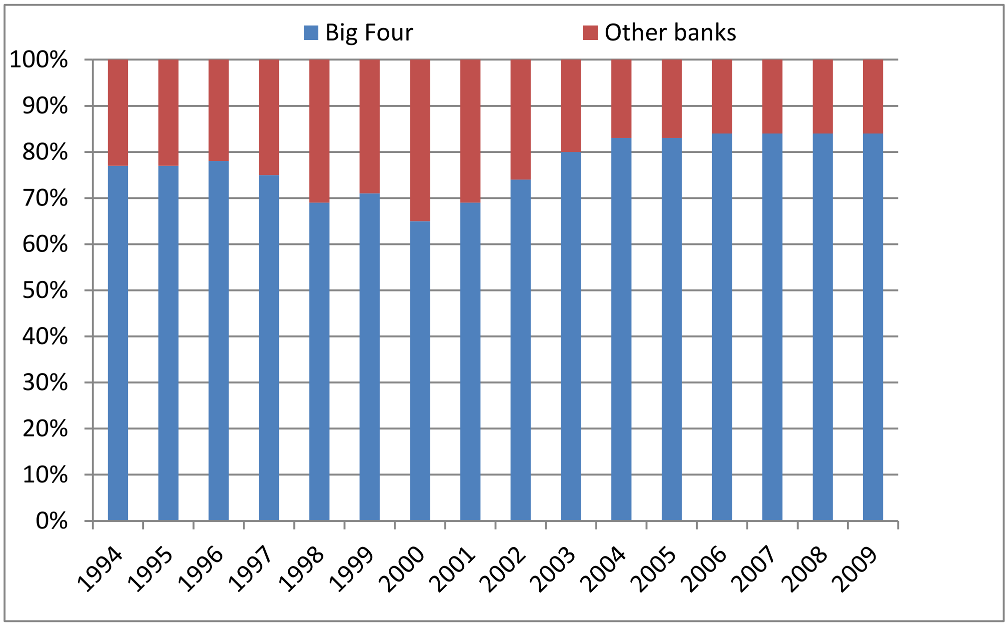
financial markets and the entry of new and re-entry of old international banks into the South African banking scene in the 1990s onwards has not brought about any meaningful competition.

Until the mid -1980's South Africa's banking sector was largely foreign owned. However due to anti-apartheid campaigns initiated by the exiled ANC, particularly in England, these foreign banks were pressured to disinvest in South Africa by divesting their shareholding, making these banks fully South African owned. One of the biggest ever anti-apartheid campaigns was waged against Barclays Bank in Britain by the Anti-Apartheid Movement (AAM) of Britain[1405]. The AAM in Britain encouraged everyone including students, local authorities, companies and universities as well as the wider population to close their accounts with Barclays Banks as it was viewed as a major financier of the apartheid regime in South Africa[1406].

According to Nerys John, British banks operating in South Africa were accused of "redirecting 'blacks' savings into the white economy"[1407]. This campaign started in the early 1970s, until Barclays relented in 1986 and sold all its shares from Barclays National Bank[1408]. It is reported that Barclays lost a lot of accounts from students, universities, local authorities and the general public[1409]. This was to the extent that after Barclays' withdrawal in 1986, the Chairman of Barclays Bank in London, Sir John Quinton, had to travel to Lusaka to meet the President of the then exiled ANC, Oliver Tambo, to urge him to convince the British campaigners that Barclays had withdrawn from South Africa[1410].

[1405] See John, N. 2000. The campaign against British bank involvement in apartheid South Africa, *African Affairs*, Vol. 99, 415-433.
[1406] *Ibid.*
[1407] *Ibid.*
[1408] *Ibid.*
[1409] *Ibid.* John writes that in 1985 Barclays in Britain lost accounts with an estimated turnover of £6000m. Prominent organisations that had closed their accounts in the 1970s included the Student Union Movement, the Lambeth Council, Nottingham Teachers Organisations, the Junior Common Room of Christ Church College in Oxford University. In the 1980 other organisations followed suit and included the Methodist Church, Catholic Institute for International Relations, the Balliol and Corpus Christi Colleges at Oxford University, Oxfam, National Association for Mental Health, Shelter, and more than 15 Labour Party controlled local authorities across Britain.
[1410] *Ibid.*

Figure 6.2: Big Four Banks versus Other Banks: Market Dominance



Source: Prepared by author from Banking Supervision Division Annual Reports covering statistics of 1994 to 2009[1411].

Gidlow (2008) attributes the exit of these banks not only to the anti-apartheid campaign, but also to historic policies and laws pertaining to foreign banks in South Africa[1412]. He argues that while during the 1970s and 1980s, many countries encouraged their banks to diversify in different geographical locations, the Afrikaner apartheid ėlite was suspect of foreign (or English) control of South African banks[1413]. The Afrikaners and the English had fought a gruelling war (the Anglo-Boer War) at the turn of 20th century and that hostility seems to have lingered on even when the Afrikaners had assumed some political control of South Africa. The Afrikaner élite, in the early 1970s, according Gidlow, adopted banking policies that restricted entry of new foreign banks into the country while also pushing for a reduction of foreign

[1411] See *Banking Supervision Division Annual Reports 1995.* South African Reserve Banks, Pretoria. *Banking Supervision Division Annual Reports 1996.* South African Reserve Banks, Pretoria, *Banking Supervision Division Annual Report 2005.* South African Reserve Banks, Pretoria. *Banking Supervision Division Annual Report 2006.* South African Reserve Banks, Pretoria. *Banking Supervision Division Annual Report 2009*, South African Reserve Bank, Pretoria.
[1412] See Gidlow, R. 2008. Foreign banks, exchange controls and the future of four pillars bank policy in South Africa. *South Africa Journal of Economic History*, Vol. 23 (1).
[1413] *Ibid.*

shareholding in South African banks[1414]. In 1970 a government Commission known as the Franzsen Commission released a report which recommended that

> "[I]f the combined shareholding of foreigners in a South African bank or bank holding company exceeded 50 per cent, such banks and holding companies should take systematic and positive steps to reduce the combined foreign shareholding to 50 per cent within a reasonable period."[1415]

This Commission further recommended that only banking institutions that were incorporated as companies in South Africa should in the future be allowed to conduct business in the country[1416]. These recommendations, according to Gidlow, were legislated into the *South African Banks Act of 1972.* Gidlow observed that these protectionist policies served to restrict competition from foreign banks, stifled foreign investment and meant that branches of foreign banks could not be set up in the country unless they were subsidiaries[1417]. According to him, all these restrictions and the anti-apartheid campaigns led to Barclays and Standard Chartered and the American owned Citibank to pull out of South Africa in the late 1980s[1418]. It was only in 1992, when the apartheid regime was negotiating a transition with South Africa's liberation movements (prominently the African National Congress) that the shareholding and entry restrictions of the 1972 Banks Act were scrapped by the *Deposit Taking Institutions Act of 1992*[1419].

Re-entry of foreign banks and investors in South Africa amidst democratic transition

Foreign banks started entering South Africa again in the 1990s following the country's transition and the legal relaxation of restrictions. In 1994 and 1995, the South African Reserve Bank Banking Supervision Division's data shows no presence of foreign bank branches[1420]. There were however

[1414] *Ibid.* p.37.
[1415] *Ibid.*
[1416] *Ibid.*
[1417] *Ibid.*
[1418] Other banks that ceased their operations or lending included US investment banks Chase Manhattan and Hill Samuel. See *Ibid.* See also John, N. 2000. The campaign against British bank involvement in apartheid South Africa, *African Affairs*, Vol. 99, 415-433.
[1419] See Gidlow, R. 2008. Foreign banks, exchange controls and the future of four pillars bank policy in South Africa. *South Africa Journal of Economic History*, Vol. 23 (1), p.37.
[1420] See *Banking Supervision Division Annual Reports 1995.* South African Reserve Banks, Pretoria. See also *Banking Supervision Division Annual Reports 1996.* South African Reserve Banks, Pretoria.

subsidiaries of foreign banks operating in the country by then[1421]. Only in 1996, do we see six branches of foreign banks in the Banking Supervision Division's statistics[1422]. As foreign banks were coming in, South African banks were also seizing the moment, like other big South African corporations, to expand their operations beyond South Africa's border. They have done that mainly through acquisitions. At a local level, these acquisitions and consolidations partly account for the decrease in the total number of locally incorporated banks.

There have also been a few liquidations and some collapses[1423]. On the issue of acquisitions and mergers locally, the South African authorities appear to have been very reluctant to allow such between the big four banks[1424]. In 2001, *Nedcor Bank* of the *Nedbank Group Limited* made a bid to acquire *Stanbic*, a division of Standard Bank Group. The authorities, it is reported, did not approve of this acquisition and the deal collapsed[1425]. The reason for this, according to Mboweni, was that the authorities believed there should be a minimum number of 'substantial banks (so called 'pillars') on which the domestic banking industry relies'[1426] (*ibid.*). The thinking is that this 'four pillar' policy assures the 'minimum levels of competition, in the interest of prudential and systemic stability'[1427]. Expansion by South African banks, locally and abroad, has to get regulatory approval from the Registrar of Banks as required by Section 52 of *the Banks*

1421 *Ibid.*
1422 See *Banking Supervision Division Annual Reports 1996.* South African Reserve Banks, Pretoria
1423 See Mbuya, J. C. 2003. *The rise and fall of South Africa's fifth largest bank (Saambou): The rise and fall of Saambou Bank*. LAP Lambert Academic Publishing, on the collapse of Saambou bank. According to Mbuya, Saambou Bank Limited collapsed in 2002 due mainly to liquidity problems after two international credit rating agencies Fitch and CA Ratings downgraded the bank's credit rating. According to him, Fitch had concerns about Saambou's profitability, asset quality, capital adequacy and liquidity and downgraded Saambou Bank's rating on 08 February 2002. Fitch released (on 09 February 2002) further credit downgrades for six other smaller South African banks including the African Bank and the African Merchant Bank. Amid these announcements, two of Saambou's executive directors are reported to have sold their shares, leading to a drop in the banks' shares. It is reported that this led depositors to lose their confidence and started withdrawing their money in numbers, causing a bank run and a liquidity crisis. On 11 February 2002, the South African Reserve Bank put the bank under curatorship and this caused further panic, where depositors withdrew their funds against smaller and even large banks (See Tito Mboweni, *Address to the End of Year Press Gala Dinner*, 14 December 2004, Pretoria). One of the banks that were gravely affected by the run was the Board of Executors (BoE) which was then the sixth largest bank by assets in South Africa (see *ibid*.). The South African Reserve Bank, together with the National Treasury, according to Mboweni (*ibid*.) acted decisively in quelling a possible systemic collapse of the country's banking system. They issued a statement where the National Treasury guaranteed banking deposits of customers in all banks, an onerous assurance in a country with no bank deposit insurance (*ibid*.).
1424 See Tito Mboweni, *Address to the End of Year Press Gala Dinner*, 14 December 2004, Pretoria.
1425 *Ibid.*
1426 *Ibid.*
1427 *Ibid.* In his speech Tito Mboweni mentioned that this 'pillar' policy is practised in other countries like Australia and New Zealand.

Act of 1990. In terms of this provision, the Registrar of Banks and the Minister of Finance, for mainly prudential and competition considerations, may refuse to grant such regulatory approval, as happened in the case of Nedcor-Stanbic deal cited above[1428]. Substantial foreign and local acquisitions by foreign banks are also subjected to regulatory approval. While the 'big four' banks have largely been locally owned since the exit of major international banks in the 1980s, this trend seems to be slowly reversing.

Table 7.7: Number of approvals for local and international expansions granted in terms of section 52 of the Banks Act, Act 94 of 1990

.	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Local	72	47	28	16	29	16	12	15	10
Foreign	44	43	31	20	17	8	25	19	28
Total	**116**	**90**	**59**	**36**	**46**	**24**	**37**	**34**	**38**

Source: Banking Supervision Division Annual Report 2009. South African Reserve Banks, Pretoria.

In 2004, the Registrar of Banks approved the purchase of majority shares (55.5 per cent) by Barclays Bank of Britain at ABSA Bank[1429]. This made ABSA the first of the 'big four' banks to be majority controlled by a foreign bank post-apartheid. In 2006, another major regulatory approval was granted to the *Industrial and Commercial Bank of China's* acquisition of 33 per cent shares of the *Standard Bank*, bringing foreign shareholding at the latter to more than 40 per cent[1430]. In August 2010, *HSBC* made an announcement that it was working on acquiring about 77 per cent of Nedbank, pending regulatory approval[1431]. However, in October 2010, HSBC announced that it was no longer acquiring shares of Nedbank. The acquisitions of local South African banks are, according to Mboweni, being treated with some caution and generally come with conditions between the foreign shareholders and the local banking regulators[1432].

Among these conditions are that: the acquired banks continue to be fully and primarily regulated by South African authorities; they are run by South Africans; and commit to adhering to the post-apartheid policies of transformation of the industry such as employment equity, improving access to the underserved

[1428] *Ibid.*
[1429] *Banking Supervision Division Annual Report 2005.* South African Reserve Banks, Pretoria.
[1430] *Banking Supervision Division Annual Report 2006.* South African Reserve Banks, Pretoria.
[1431] *Financial Mail* 25 August 2010.
[1432] Tito Mboweni, *Address to the End of Year Press Gala Dinner*, 14 December 2004, South African Reserve Bank, Pretoria.

populations and advancing the ANC government's policy of black economic empowerment[1433]. These transformation policies normally apply not only to banks, but also to other significant industries which, in the past, racially discriminated or excluded large sectors of population from ownership, management and control.

When the South African economy opened up and foreign banks (re)entered the market, there were hopes that the big international banks would enhance the level of competition within the country's retail banking sector. However, as it appears, the big foreign banks have not set up any 'greenfield' retail banking operations in South Africa[1434]. For whatever reasons, they have preferred to cement the dominance of the big four banks by buying controlling shares in them. *Barclays* and the *Industrial and Commercial Bank of China's* deals on ABSA and Standard Bank respectively were the first such acquisitions since 1994. Whether this is good, in terms of competition, for the South African consumers and the economy at large has been an ongoing debate. In an interview with the *Financial Times*, Tito Mboweni criticised the ABSA-Barclays deal by accusing Barclays of being interested only in 'repatriating' dividends out of South Africa to Britain[1435]. He also criticised ABSA, saying he was yet to see it introduce new products and competition in the South African market as a result of its relationship with Barclays[1436].

It seems a popular view that smaller new local banks trying to break into the retail banking market in South Africa have found it highly concentrated and hard to penetrate because of the dominance of the 'big four'[1437]. A Banking Enquiry Report into retail banking competition instituted in terms of *South Africa's Competition Act of 1998* opined that unless the government updated its laws and regulations on bank fees and charges and barriers to entry, it was unlikely that South Africa will see any 'Greenfield' investments in the retail banking sector[1438]. According to this report, South African banking laws and regulations promoted uncompetitive and non-transparent pricing of banking products[1439]. They further promoted barriers to entry for new banks and monopolised access to the national payment system through

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[1433] *Ibid.*
[1434] See also Gidlow, R. 2008. Foreign banks, exchange controls and the future of four pillars bank policy in South Africa. *South Africa Journal of Economic History*, Vol. 23 (1).
[1435] *Mboweni fires confounding salvo at Barclays.* Business Report, 03 March 2007. *The Star Newspaper* (South Africa- Johannesburg) .
[1436] *Ibid.*
[1437] *The Banking Enquiry Report 2008*, Competition Commission of South Africa.
[1438] *Ibid.*
[1439] *Ibid.*

high fixed fees[1440]. The report concluded that while South African banks did not operate as a cartel and there had been no evidence of price collusion, the 'big four' formed an 'oligopoly' to the disadvantage of South African consumers[1441].

This continuing trend of acquisitions by returning and new investors in the South African retail banking market, it appears, is likely to continue unless there are some drastic reforms. Despite being proposed by the *Banking Enquiry Report*, they have so far not been implemented by the authorities. This is especially true of those reforms relating to bank charges which are claimed to be some of the highest in the world. The *Banking Enquiry Report* further observed that South African banks, on top of levying monthly administrative charges on bank accounts, seem to charge for everything else, including the making of deposits and withdrawals, checking account balances at ATMs, internet and telephone banking, point of sale (POS) transactions, among others[1442].

[1440] *Ibid.*
[1441] *Ibid.*
[1442] *The Banking Enquiry Report 2008*, Competition Commission of South Africa.

Appendix 6.2: Regulations 3 (1), 4 (1) and 4 (2) of the Anti-Money Laundering Regulations of 2002

Regulation 3 (1) prescribed that; An accountable institution must obtain from, or in respect of, a natural person who is a citizen of, or resident in, the Republic, that person's---

a) Full names; b) date of birth; c) identity number; income tax registration number, if such a number has been issued to that person; and e) residential address.

Regulation 4 (1) prescribed that; An accountable institution must verify the full names, date of birth and identity number of a natural person referred to in regulation 3 (1)…by comparing these with –

a) (i) an identification document of that person; or (ii) in the case where that person is, for a reason that is acceptable to the institution, unable to produce an identification document, another document issued to that person, which, taking into account any guidance notes concerning the verification of identities which may apply to that institution, is acceptable to the institution and bears; (aa) a photograph of that person; (bb) that person's full names or initials and surname; (cc) that person's date of birth, and (dd) that person's identity number.

Regulation 4 (3) reads as follows; "An accountable institution must verify the residential address referred to…by comparing these particulars with information which can reasonably be expected to achieve such verification and is obtained by reasonably practical means, taking into account any guidance notes concerning the verification of identities which may apply to that institution."

Appendix 6.3: List of global standards and codes of International Financial Institutions

The global standards and codes include; IMF's *Special Data Dissemination Standard and General Data Dissemination System*; IMF's *Code of Good Practices on Fiscal Transparency;* IMF's *Code of Good Practicces on Transparency in Monetary and Financial Policies;* Basel Committees' *Code Principles for Effective Banking Supervision;* International Organisation of Securities Commission's (IOSCO) *Objectives and Principles for Securities Regulation*; International Association of Insurance Supervisor's (IAIS) *Insurance Supervisory Principles;* Committee on Payments and Settlements Systems' (CPSS) *Core Principles for Systemically Important Payments Systems*; CPSS-IOSCO Joint Task Force's *Recommendation for Securities Settlement Systems*; FATF's *48 AML/CFT Recommendations;* OECD's *Principles of Corporate Governance;* International Accounting Standards Board's *International Accounting Standards*, International Federation of Accountants' *International Standards on Auditing* and the World Banks' *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*. Retrieved from: http://www.imf.org/external/standards/scnew.htm

Appendix 6.4: More on Mzansi Account and Branchless Banking

It is important to note that not all the accounts opened during this period were as a result of the Mzansi initiative but rather were due to the FSC. We say this because while the Mzansi initiative was a collaboration of the big four and the PostBank, the FSC was an agreement involving all other commercial banks and financial sector players. The smaller, and mostly newer, commercial banks deemed this not a suitable product for them[1443]. The reason for this was that, contrary to the big four, they had already been exclusively targeting the low-income market with various transactional products, including loans[1444]. Their share in that market was growing substantially. However their combined effort was not far-reaching enough to bring the all or even most of those millions of un-banked South Africans into the fold[1445]. It would appear that the big four banks, hiding behind the legitimacy of the FSC and collaboration with the PostBank, had colluded to introduce the Mzansi account. Although a far reaching initiative, it also served to re-assert the 'big four' market power and oligopoly in the face of competitive challenge from the new commercial banks.

It could well be argued that the Mzansi initiative, if scrutinized in the light of the country's competition laws, could be found wanting as *South Africa's Competition Act of 1998* prohibits price collusion. Firstly, the Mzansi Initiative not only established a common brand between the competing dominant South African banks but also exhibited common features and an almost identical pricing structure[1446]. The common features were the issuance of a debit card, a ceiling on balances and transaction values, and restrictions on certain electronic payment services[1447].

The common pricing arrangements included the absence of monthly administration fees and no difference in pricing between withdrawals on a bank's own ATM and withdrawals using another Mzansi participating bank's ATM[1448]. The functional features of the product were therefore similar and the product cost structure almost the same. The similarities were to the extent that it made no material product and price difference for a customer to open an Mzansi account at FNB as opposed to Nedbank, for instance. In a

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1443 Bankable Frontier Association, LLP. 2009. *The Mzansi Bank Account Initiative in South Africa*. FinMark Trust. South Africa, 20 March 2009, p.19. Retrieved from: http://www.finmarktrust.org.za/documents/R_Mzansi_BFA.pdf,
1444 *Ibid.*
1445 *The Banking Enquiry Report 2008*, Competition Commission of South Africa.
1446 Bankable Frontier Association, LLP. 2009. *The Mzansi Bank Account Initiative in South Africa*. FinMark Trust. South Africa, 20 March 2009. p.3. Retrieved from: http://www.finmarktrust.org.za/documents/R_Mzansi_BFA.pdf
1447 *Ibid.*
1448 *Ibid.*

competitive market, consumers should be able to choose a product and a supplier of that product based on costs. Mzansi did not provide this choice to the consumers, further asserting the market dominance of the big four banks -- possibly at the expense of other smaller players such as Capitec and Teba Banks who had already targeted the low-income market[1449]. The market power that the big four banks already enjoyed would, therefore, have made competition with them in that market by the smaller players difficult. However, this collusion appears to have been tolerated, marketed and later justified on the back of its outcomes.

The BFA report shows that the Mzansi initiative has so far been one of the products that contributed a lot in enabling and giving access to first order financial services to many South Africans who would otherwise have not been reached so quickly without the cooperation, the marketing drive and the combined infrastructure of the big four banks and the Post-bank[1450]. The study further shows that two thirds of the 6 million accounts opened under the Mzansi initiative between 2004 and 2008 were opened by customers who had never had a bank account before[1451]. The Mzansi account holders had an increased access as they could use facilities of any participating bank, without additional costs, as compared to holders of other entry level non-Mzansi accounts offered by the big four banks and their competitors[1452]. Other features which were not offered at the introduction of Mzansi are now on offer at some of the banks, such as the use of debit order facilities, internet and mobile-phone banking[1453].

Despite all the successes of Mzansi, however, the BFA research found that of the 6 million Mzansi accounts opened, only 3.5 million remained active at the end of 2008. Nonetheless that is 18 per cent of the total number of banked South Africans and 11 per cent of the adult population[1454]. This means that about 42 per cent of the Mzansi accounts opened were 'inactive' four years later. Recent news articles claim that more and more Mzansi accounts are becoming inactive. Inactive accounts, according to the BFA report, are those that have been closed by customers or are dormant[1455]. Dormant accounts are those that had not been used for a consecutive 12 calendar months period[1456]. The BFA Mzansi report finds that while this number

[1449] Bankable Frontier Association, LLP. 2009. *The Mzansi Bank Account Initiative in South Africa*. FinMark Trust. South Africa, 20 March 2009. Retrieved from: http://www.finmarktrust.org.za/documents/R_Mzansi_BFA.pdf
[1450] *Ibid.*
[1451] *Ibid.* p.3.
[1452] *Ibid.*
[1453] *Ibid.*
[1454] *Ibid.*
[1455] *Ibid.*
[1456] *Ibid.*

of inactive Mzansi accounts may seem huge, it is still lower than the average rate of inactivity of other nearest entry-level bank accounts[1457].

The report further suggests that the inactive 42 per cent of the Mzansi accounts should not only be viewed negatively[1458]. There were positive explanations to the closure and dormancy of these accounts, as some are a result of customers upgrading to better products[1459]. The FSC, with the introduction of Mzansi and encouraging others who did not participate in the Mzansi initiative to introduce new mass market products has been viewed by many to be a major success in bringing financial services to the people. There are other services beyond the Mzansi initiative that have been unrolled in order to try and extend financial services access in South Africa. These are such new services as branchless banking which are directed at serving the unbanked[1460]. These services use mobile phones and retail outlets to let consumers deposit, transfer and withdraw cash and have proved very transformational in extending financial services in Africa and other developing countries where there is a shortage of brick and mortar banks, while at the same time, there is a mobile phone revolution[1461].

Beyond Mzansi: Branchless Banking

One important development in recent years is the appearance of branchless banking. Branchless banking is defined as "the delivery of financial services outside conventional bank branches using information and communication technologies and retail agents."[1462] There are two models of branchless banking -- the 'bank-based' and 'non-bank based' model[1463]. The former involves customers having a contractual relationship with a bank -- through a bank account or to access financial services through retail agents such as merchants, supermarkets and post offices[1464]. This access may enable such transactional

1457 *Ibid.*
1458 *Ibid.*
1459 *Ibid*.
1460 See below.
1461 *Ibid.*
1462 CGAP .2008. *Notes on Regulation of Branchless Banking in South Africa*. CGAP Technology Program, Washington. p.1.
1463 *Ibid.* p.2.
1464 *Ibid.*

facilities as cash withdrawal, deposit and transfer through the use of hand held devices, particularly a mobile phone or a point-of-sale (POS) terminal[1465].

The non-bank-based model involves access to financial services by customers with no direct contractual relationship with a fully prudentially licensed and supervised financial institution[1466]. Through this model, the customer is enabled to exchange cash at a retail agent such as a merchant, supermarket or post office in return for an electronic record of value[1467]. This value is stored in an electronic server of a non-banking institution such as a mobile phone operator or an issuer of a stored value card[1468]. The balance in this virtual account can then be used for making payments, storing funds for future use, transferring or converting this value back to cash at retail participating agents[1469]. With stored value cards, customers would therefore use the participating agents to transfer, withdraw and deposit cash[1470]. However with mobile phone operator services, customers would use their registered sim-cards in a mobile phone in order to transfer money[1471].

They would however have to visit a participating agent to top-up (deposit) or convert any portion of the balance[1472]. David Porteous refers to the bank-based models as 'additive models' as they merely add another channel of transacting on an existing bank account/service[1473]. They are more like accessing a bank account via the internet or ATM as opposed to visiting your branch. He refers to the non-bank-based models as 'transformational models' as they target the un-banked in developing countries, who are largely low-income customers[1474]. These services have grown in South Africa, as they have in many other developing countries, mainly tapping into the innovative software of mobile phones to extend access to financial services.

[1465] *Ibid.*
[1466] *Ibid.*
[1467] *Ibid*.
[1468] *Ibid.*
[1469] *Ibid.*
[1470] *Ibid.*
[1471] *Ibid.*
[1472] *Ibid.*
[1473] Porteous, D. 2006. *The enabling environment for mobile banking in Africa*. Report Commissioned by Department for International Development (DFID UK), Boston USA.
[1474] *Ibid.*

These mobile banking (m-banking) services in South Africa emerged just after the adoption of the *Financial Services Charter*, discussed earlier , with a focus on the un-banked masses. Researchers in this area of financial inclusion argue that m-banking services offer opportunities for access to financial services which are transformational in places like Africa and other developing regions. This is because more people have mobile phones in Africa than have bank accounts. They also have limited access to traditional banking infrastructure such as ATMs and branches. Tapping into the already extensive infrastructure and coverage of the mobile phone networks and devices, a number of schemes are emerging throughout Africa, East Asia, Middle-East and Latin America that focus mainly on the un-banked. In South Africa, there has also been this revolution with a number of non-bank service providers forming alliances with banks and mobile phone companies to extend these services. This includes such services as WIZZIT[1475], MTN Mobile Money[1476] and M-PESA[1477].

These three non-bank initiatives are offered by mobile phone network operators (MTN) and Vodacom (M-PESA) and a private company (WIZZIT), at the back of registered bank licenses of their partners, Standard Bank (MTN MobileMoney), Nedbank (M-PESA) and the South African Bank of Athens (WIZZIT). Due to South African regulatory requirements which prohibit non-banking companies from deposit taking, they had to collaborate with registered banks[1478]. The question, however, is whether these banking initiatives comply with South Africa's AML/CFT KYC regulations?

These innovative and transformational products could be vulnerable to identity theft and money laundering due to their non-face-to-face account opening procedures. Obviously, no address verification is conducted with these products. For instance, a criminal could steal and assume many identities of economically inactive victims and use them to virtually open bank accounts and enjoy the use of these facilities. All s/he needs is to punch a valid ID number of a person who does not have an active MTN MobileMoney or M-PESA in his/her mobile phone and start banking.

[1475] See https://www.wizzit.co.za.
[1476] See https://mtnbanking.co.za.
[1477] See http://www.howwemadeitinafrica.com/m-pesa-launched-in-south-africa/3611/ M-Pesa launched in South Africa 1 September 2010.
[1478] See Porteous, D. 2006. *The enabling environment for mobile banking in Africa*. Report Commissioned by Department for International Development (DFID UK), Boston USA.

Appendix 7.1: Uses of FTRs for law enforcement purposes

Here we look at the claimed and known uses of FTRs by LEAs in more depth. An issue arising from the reporting of customer transactions is whether they actually assist in detecting and combating crime. If so how and to what extent? Can such benefits be quantified? The quantitative model used by the FATF and other studies, as discussed below, have shown that a very low number of FTRs are directly linked to positive crime detection outcomes, such as convictions and asset seizures, confiscation and forfeiture. This is not to say that they do not assist in the detection of crime. They do, but, it appears, to an extremely limited extent. If that is the case, why do countries subject themselves to such extensive systems of regulatory surveillance and reporting? Let us look at the claimed uses of FTRs for law enforcement purposes.

Matthew Fleming has discussed these very meticulously in a study he conducted in the UK[1479]. According to him, FTRs are used for 'tactical reasons' to; identify previously unknown criminal(s)/terrorist(s); identify the previously unknown criminal/terrorist activity of a known criminal/terrorist; corroborate known criminal/terrorist activity; identify criminal/terrorist networks; enhance existing criminal/terrorist investigations (e.g. with new avenues for investigations); identify/locate assets for cash seizure/forfeiture, restraint/confiscation and so on; assist in confiscation order enforcement (and potentially, fine enforcement); prevent dissipation of assets and/or disrupt current criminality/terrorist funding and; to identify patterns of high- or low-volume reporting for regulated entity for self-assessment or regulatory/LEA follow up[1480].

They are also used for 'strategic reasons' to; identify the potential duplicity of regulated entities (where institutions report same FTRs); contribute to strategic assessment (such as crime threats assessments); identify the main threats, risks, patterns, and emerging trends in money laundering/financial crime, including identifying typologies to better understand the problem and; to satisfy international commitments[1481]

We are not going to explain all of these, as they seem pretty straightforward. We would however say a word about what 'tactical' and 'strategic' uses refer to in the context of criminal or financial intelligence. By tactical uses is meant short-term operational uses to investigate and prosecute crime

[1479] Fleming, M.H. 2005. *The UK Law Enforcement Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime*, University College London. Retrieved from: http://www.jdi.ucl.ac.uk/
[1480] *Ibid.*
[1481] See *Ibid.*

(including asset forfeiture)[1482]. Strategic uses refer to their utilisation to analyse and understand patterns, trends and typologies which could be used to target particular syndicates or areas of crime and influence management decisions[1483]. To an extent, the reporting patterns and nature of FTRs could help FIUs and authorities to take strategic decisions to ensure the effectiveness and efficiency of the regime. In our view, FTRs that assist in tactical operations could also be used for strategic analysis or assessments. This is simply because from such FTRs, the FIUs and LEAs get to know what crimes these FTRs have helped to solve. From this knowledge they can then draw trends, patterns and typologies for future planning.

The hundreds and millions of other FTRs that have achieved no tactical outcome would arguably be less useful for any law enforcement purpose. They can however be very useful for management purposes in that they can show the administrators of the reporting regime that a lot of money is being spent filing (by regulated business), assessing (by FIUs) and investigating (by LEAs) them to no avail. Their ineffectiveness can therefore encourage change or perhaps embolden decision makers to, (although this seems highly unlikely), abandon the reporting regime altogether as it fails or does not assist in the combating and detection of crime.

Research and practice show that not all FTRs end up being assessed by FIUs or referred for investigations to LEAs[1484]. This means, therefore, that not all FTRs end up initiating new investigations or helping in the gathering of evidence or as intelligence in ongoing investigations[1485]. By investigations is meant evidence collection for court-directed actions such as prosecution and assets forfeiture[1486]. According to Fleming, FTRs should not always lead to the initiation of investigations[1487]. The reasons he advances for this are that when FTRs are received by FIUs, they are not necessarily 'intelligence' but just information. In this respect, he defines 'intelligence' as "processed and corroborated information which may be of tactical or strategic use for law enforcement and management purposes"[1488]. To be turned into intelligence, they therefore need to be corroborated through various database checks. This initial assessment helps to determine whether they could be of any immediate tactical use or they could otherwise be used later, if at all.

[1482] *Ibid.*
[1483] *Ibid.*
[1484] *Ibid.*
[1485] *Ibid.*
[1486] *Ibid.* p. 15.
[1487] *Ibid.*
[1488] *Ibid.* p. 13

He argues that it would be uneconomic for LEAs to turn every single FTR into an investigation. The "deployment of investigative operational teams to fully investigate each and every [FTR] as received is almost certainly not the best use of limited resources"[1489]. A practice he advocates is that, unless an FTR "clearly indicates serious criminality", it is better to deploy full investigative resources on cumulative, multiple FTRs[1490]. However, Fleming also acknowledges that such a practice could be problematic in that potentially useful FTRs could end up being overlooked because they did not clearly indicate any serious criminality[1491]. There are therefore these serious practical management dilemmas for FIUs and LEAs which are daily flooded with hundreds to millions of FTRs. The problem is how to prioritise some and not others. Another major issue is whether it is justifiable enough for regulated businesses to be expected to spend so much of their resources monitoring and filing FTRs that would not be assessed and investigated because FIUs and LEAs have capacity and resource constraints. In other words, why promulgate laws and regulatory prescriptions that cannot effectively and efficiently be enforced? Implementing unenforceable regulations renders them obsolete and inefficient.

Even those FTRs that end up being assessed by FIUs and investigated by LEAs, either on their own (single FTRs) or cumulatively (multiple FTRs), as evidence from various sources show, end up revealing neither money laundering nor its predicate offences and terrorist financing. Statistics have always shown that FTRs that end up helping to detect crime; either through, at some stage, having new investigations initiated or helping in ongoing investigations are between less than 1 and 15 percent at most, per annum. Some governments are looking for ways to minimise the filing of FTRs which are known to be useless for crime detection purposes[1492]. There have been reasons given to justify such insignificant successes of FTRs.

These reasons are mainly that; 1. LEAs do not provide feedback to FIUs nor keep statistics on the outcomes of FTRs; 2. the quality of FTRs received from regulated businesses is poor and; 3. the lack of capacity and resources by FIUs and LEAs to assess and investigate FTRs[1493]. On the latter issue, as discussed above, the issue is are that both FIUs and LEAs lack the capacity and resources. What affects FIUs the most could be issues of shortage of well-trained staff dedicated to analysing and disseminating good quality and actionable intelligence to LEAs. On the side of LEAs, the issue of capacity relates to

[1489] *Ibid.* p. 15
[1490] *Ibid.*
[1491] *Ibid.*
[1492] See discussion, later below, on United States and UK FTR reviews.
[1493] Fleming, M.H. 2005. *The UK Law Enforcement Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime*, University College London. Retrieved from: http://www.jdi.ucl.ac.uk/

issues of priority, where officers have got court deadlines to meet on pending cases rather than giving priority to suspicions which may well turn out to be legitimate transactions.

On the second issue of feedback and statistics, which appears frequently in country Mutual Evaluation Reports of the FATF, the charge is that LEAs do not provide feedback to FIUs nor keep track and statistics of the outcomes of FTRs. This reason seems to suggest that FTRs do have some beneficial outcomes but lack feedback and record keeping by LEAs and FIUs. It appears that lack of proper management practices to provide feedback and keep statistics may make it difficult to assess the effectiveness and efficiency of FTR regimes. Recommendation 32.2 of the FATF, for instance, requires the maintenance of "comprehensive statistics on matters relevant to the effectiveness and efficiency of the systems for combating money laundering and terrorist financing"[1494]. This recommendation requires the keeping of annual statistics on FTRs received by FIUs and disseminated to end-users (LEAs). It requires that there is a breakdown of types of regulated institutions who are making these reports. This may show which institutions are not reporting and assist in directing regulatory supervision, among other things.

The latter Recommendation also requires the keeping of statistics on outcomes of FTRs, i.e. investigations, arrests, prosecutions, and convictions for money laundering and its underlying offences and terrorist financing. A number of FATF mutual evaluation reports of many countries show that this information is not kept by some FIUs, due to lack of feedback from LEAs. This is therefore a management issue, where FIUs need to put mechanisms in place to ensure that all FTRs referred to LEAs are traceable and their outcomes are recorded. The former head of SOCA (UKFIU), Sir Stephen Lander, formed a Suspicious Activity Reports Committee in order to ensure that LEAs provide feedback and keep statistics, among other issues[1495]. LEAs across the UK provide the SARs Committee with feedback twice per annum[1496]. This allows the Committee to compile a report on the successes achieved by SARs and to propose areas of improvement[1497].

According to Sir Stephen Lander's *UK SARs Review Report*, the keeping of statistics and provision of feedback are important because they enable SOCA to "provide assurance to those [regulated businesses]

[1494] See FATF. 2003. *FATF 40+9 Recommendations against money laundering and counter financing of terrorism*. FATF Secretariat, OECD, Paris.
[1495] Serious Organised Crime Agency. 2006. *Review of the Suspicious Activity Reports Regime (The SARs Review)*, Sir Stephen Lander, March 2006, p.30. Retrieved from: http://www.soca.gov.uk/about-soca/library/doc_download/80-lander-review-2006
[1496] *Ibid.*
[1497] *Ibid.*

expending effort and resources to disclose the information that it is being put to good use"[1498]. Other advantages mentioned by Lander are that feedback enables SOCA to; provide "examples of success to help encourage continued effective cooperation"; "help reporters develop an accurate view of the risks to their business from laundered money and terrorist financiers"; "enable the tracking of outcomes in relation to specific types of SARs or different reporting sectors, thus allowing lessons to be learnt about what should be reported in the future"; "provide evidence on the relative merits of different methodologies used to identify leads from the database, thereby assisting with future database design"; "aid continuous regime improvement, enabling insights into not only the quality of SARs inputted, but also the support SOCA is providing to users"; "enables SOCA to disseminate examples of good practice throughout the use community" and; "contributes to SOCA's ability to build the overall serious organised crime intelligence picture"[1499].

On issues of quality of FTRs, regulated businesses are often blamed for not filing good quality FTRs[1500]. This means that when filing a report, they would not provide, among other things, clear reasons for their suspicions[1501]. Another problem identified with regards to quality is that regulated institutions, as discussed earlier , sometimes file reports which they would otherwise not file, just to avoid being on the wrong side of the regulators[1502]. This has been referred to as 'defensive reporting' and results from the regulated businesses' pre-emptive measures to avoid legal/regulatory sanctions. In this process, businesses start to flood the system, even with poor quality FTRs. The uses of FTRs could therefore be divided into two main categories. Firstly, they assist law enforcement on their investigations. This could be through starting new investigations or assisting in on-going ones. Secondly, they assist FIUs and LEAs by providing strategic information which may not only help with investigations, but also with the management of financial surveillance regimes.

[1498] *Ibid.*
[1499] *Ibid.*
[1500] See Government Accountability Office. 2009. *Bank Secrecy Act: Suspicious Activity Report Use is Increasing, but FinCEN Needs to Further Develop and Document Its Form*. Report to Congressional Requesters. United States (February 2009) p.11
[1501] *Ibid.*
[1502] *Ibid.*